83-614

No. 83-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

At issue is a decision of the Court of Appeals upholding a ruling of the Federal Reserve Board. That decision permits the largest bank holding company in the United States to acquire the nation's largest discount broker and thereby to engage in public securities brokerage—a business no bank affiliate has conducted since federal restrictions on bank securities activities were enacted in the wake of the national banking crisis fifty years ago. The specific questions presented are:

1. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that a nonbanking activity, here public securities brokerage, is "so closely related to banking . . . as to be a proper incident thereto" within the meaning of the Bank Holding Company Act, where the activity is not one traditionally performed by banks, or even one that supports a banking activity, but is only "functionally similar" to some banking operations?

2. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that the flat prohibitions of the Glass-Steagall Act restricting both direct and indirect securities activities of banks need not be construed consistently, so that depending upon an administrative view of the risks posed, a bank affiliate may be authorized to engage principally in securities activities that are barred entirely to banks?

PARTIES TO THE PROCEEDING

In addition to the petitioner* and respondents listed in the caption, the following are also respondents in this action: Paul A. Volcker as Chairman of the Board of Governors of the Federal Reserve System, Preston Martin, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmet J. Rice and Lyle E. Gramley, as Members of the Board of Governors of the Federal Reserve System, and BankAmerica Corporation as Intervenor in the proceeding below.

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* Pursuant to Rule 28.1 of this Court, petitioner states as follows: The Securities Industry Association is a national trade association representing more than 540 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States.

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Petitioner, the Securities Industry Association ("SIA"), respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on July 15, 1983.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (1a)[1] is unreported. The January 7, 1983 order of the Board of Governors of the Federal Reserve System ("Board") approving

1 Citations to material printed in the Appendix submitted herewith appear as "____a".

the application of BankAmerica Corporation to acquire The Charles Schwab Corporation (21a) is reported at 69 Fed. Res. Bull. 105 (1983).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 15, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This action concerns two federal statutes designed to restrict the commercial activities of banks and their affiliates: the Glass-Steagall Act,[2] and the Bank Holding Company Act.[3]

Enacted in 1933 after the collapse of the banking system, the Glass-Steagall Act prohibits banks entirely from engaging in certain securities activities, and it restricts banks from indirectly doing so by prohibiting either affiliation or management interlocks with entities principally or primarily engaged in these activities.

Sections 16 and 21 of the Act apply to the direct activities of banks. Section 16 defines the incidental powers that may be exercised by a national bank, and provides:

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no

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2 The Glass-Steagall Act was enacted as part of the Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, and is codified in different sections of Title 12 of the United States Code. Relevant to this petition are Sections 16, 20, and 21 of the Act, 12 U.S.C. §§ 24 (Seventh), 377, 378. The relevant sections are set out in the Appendix (53a-55a).

3 12 U.S.C. §§ 1841, *et seq.* Relevant text of this Act is also set out in the Appendix (56a).

> case for its own account, and the [national bank] shall not underwrite any issue of securities or stock . . .

12 U.S.C. § 24 (53a). Section 21, in parallel fashion, makes it unlawful for any organization that is "issuing, underwriting, selling, or distributing" securities, to engage "to any extent whatever in the business of receiving deposits." 12 U.S.C. § 378(a)(1) (54a).

Section 20 restricts banks from indirectly engaging in the prohibited activities by providing that no member bank of the Federal Reserve System may be affiliated with an organization,

> engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities.

12 U.S.C. § 377 (54a). Section 32 similarly prevents officer, director, or employee interlocks between any member bank of the Federal Reserve System and any entity primarily engaged in "the issue, flotation, underwriting, public sale or distribution" of securities. 12 U.S.C. § 78 (55a).

The Bank Holding Company Act, enacted in 1956, prohibits bank holding companies from owning or controlling any entity engaged in "activities other than banking," 12 U.S.C. § 1843(a), with only limited, expressly defined exceptions. The one exception relevant here is contained in Section 4(c)(8) of the Act, which, as amended in 1970, allows a bank holding company to own an entity,

> the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking as to be a proper incident thereto.

12 U.S.C. § 1843(c)(8) (56a).

STATEMENT OF THE CASE

A. The Administrative Proceedings

On March 8, 1982, BankAmerica Corporation ("BAC"), the parent holding company of this nation's largest bank, applied to the Board under Section 4(c)(8) of the Bank Holding Company Act for permission to acquire The Charles Schwab Corporation, a company principally engaged in public securities brokerage through its wholly-owned subsidiary, Charles Schwab & Co., Inc. ("Schwab"). (3a.) Public securities brokerage is a nonbanking activity which the Board had never previously found to be permissible for a bank affiliate under Section 4(c)(8). The Board published notice of BAC's application, and requested comments from interested parties. (2a; *see* 47 Fed. Reg. 16104 (April 14, 1982).)

SIA objected to the application and requested an evidentiary hearing thereon. The Board scheduled an expedited hearing before an Administrative Law Judge to consider issues raised by the SIA.[4] Following the submission of written statements and rebuttal testimony, a six-day hearing was held for purposes of cross-examining witnesses. (22a.) After submission of post-hearing briefs, the Administrative Law Judge filed a Recommended Decision favoring the acquisition. And, on January 7, 1983, the Boar issued an order approving the first affiliation between a bank holding company and a brokerage firm since the early days of the Great Depression. (4a.)

In its order, the Board found that BAC's proposed securities brokerage activities were permissible under Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, even though that Section of the Act prohibits banks from affiliating with organizations "engaged principally" in the "public sale" of securities. (54a.) The Board conceded that banks had not previously engaged in the sort of retail brokerage business conducted by Schwab

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4 Upon consent, the Department of Justice was permitted to intervene in the proceeding before the Board. (22a.)

(25a) and did not find that Schwab's brokerage business would facilitate otherwise proper banking activities. The Board nevertheless concluded that discount securities brokerage, as conducted by Schwab, was an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act. The Board reached this conclusion merely because in its view the activity was "operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well-equipped to provide such services." (25a; footnote omitted.) The Board also concluded that the acquisition satisfied the "net public benefits" test of Section 4(c)(8). (42a.)

The SIA filed a timely petition with the Court of Appeals for the Second Circuit, pursuant to 12 U.S.C. § 1848, seeking review of the Board's unprecedented order.

B. The Court of Appeals Decision

The Court of Appeals deferred to the Board and accepted its construction of the terms of both the Glass-Steagall Act and the Bank Holding Company Act. (3a.)

Although four sections of the Glass-Steagall Act restrict the securities activities of banks and their affiliates, the Second Circuit held that the acquisition should be judged only against the "public sale" provision of Section 20 which, it concluded, should not be read to include brokerage activities. (5a.) The court was unpersuaded that Section 20 should be read consistently with Section 16 of the Act, which expressly restricts the securities brokerage activities of banks. (12a.) The court was of the further view that bank affiliates could be permitted under Section 20, depending upon the Board's assessment of the risks involved, to engage principally in securities activities that are barred entirely for banks. (12a.)

In holding the acquisition also to be acceptable under the Bank Holding Company Act, the court below embraced the Board's interpretation that Section 4(c)(8) permits a nonbank

affiliate to engage in *any* activity that is operationally similar to a banking activity. (15a.) The court rejected any construction of Section 4(c)(8) that would provide that bank holding company activities which are not traditionally performed by banks must be undertaken only in furtherance of otherwise permissible bank activites before they can be deemed to be "so closely related to banking . . . as to be a proper incident thereto." (18a.)

REASONS FOR GRANTING THE WRIT

I.

THE COURT OF APPEALS DECISION RAISES IMPORTANT ISSUES OF NATIONAL SIGNIFICANCE

Reversing fifty years of consistent understanding of the limits imposed by federal law, the administrative ruling at issue allowed the largest bank in the nation to affiliate with this country's largest discount broker. This ruling is itself of major significance. The decision below, however, has an even broader importance, in that it substantially revises the existing statutory limitations on the activities of bank affiliates and the authority of bank regulators. (*See*, *infra*, pp. 11-18.)

This is the second case to reach this Court concerning bank securities activities only recently sanctioned by federal banking regulators. Like the first such case, the decision herein is of general applicability.[5] It holds not merely that BAC may acquire Schwab, but that *all* bank holding companies may acquire securities brokers. Less than one month after entry of the decision below, the Board promulgated new regulations

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[5] In *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766 (*cert. granted* October 3, 1983), this Court agreed to review a Court of Appeals decision affirming the Board's determination that banks may underwrite short-term, large denomination notes, despite the flat prohibition of the Glass-Steagall Act barring bank marketing of "notes or other securities."

specifically adding securities brokerage to its list of activities that are generally permissible to bank holding companies. *See* 48 Fed. Reg. 37003 (Aug. 16, 1983).

It is especially significant that this decision comes at a time when Congress itself has been considering major legislative proposals to alter existing federal restrictions on financial institutions.[6] In each of several recent sessions Congress has enacted major reforms to the federal banking laws,[7] but, in each instance, Congress has determined not to modify existing restrictions on bank securities activities.[8]

Federal banking regulators, in turn, have been under intense pressure from the institutions they regulate simply to rewrite

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6 *See, e.g.*, Financial Institutions Deregulatory Act, S. 1609 and H.R. 3537, 98th Cong., 1st Sess. (1983), which would substantially expand existing powers of bank holding companies. In addition to this proposal, Congress currently is considering legislation to reform the federal deposit insurance system, ban the acquisition of banks by non-depository institutions, restructure the federal system for regulating financial institutions and reform the requirements of membership in the Federal Reserve System. *See Congress Not Expected to Move on Any Major Reform Bills This Year*, 41 Wash. Fin. Rep. (BNA) No. 10 at 326 (Sept. 12, 1983).

7 *See* Garn-St.Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

8 To the contrary, Congress has reaffirmed its support for the prohibitions on bank securities activity. In 1980, for example, Congress expressed its continuing opposition to any administrative adjustment of the Glass-Steagall prohibitions when it enacted the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. No. 96-221, 94 Stat. 132 (1980). In that Act, Congress extended to the Comptroller of the Currency authority to issue such rules as were needed to "carry out the responsibilities of the office," but specifically made clear that the Comptroller had *no* authority to issue regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act'." 12 U.S.C. § 93a.

previously recognized limits on the activities of banks and bank affiliates, without Congressional action. The application challenged here itself set off a wave of applications to other banking agencies, followed by a series of administrative "interpretations" authorizing a variety of bank securities brokerage activities for the first time in half a century. Thus:

— The Comptroller of the Currency has repudiated his long-standing construction of the Glass-Steagall Act as barring public brokerage activities by national banks (an interpretation first articulated in hearings in 1934 before the Congressional Committees considering the initial amendments to the Act, and consistently followed for half a century);[9]

— The Federal Deposit Insurance Corporation has adopted new rules that will permit not only brokerage but securities underwriting by affiliates of the 9,000 state chartered banks under its jurisdiction;[10] and

— The Federal Home Loan Bank Board has authorized the first nationwide joint venture by federally chartered savings and loan associations in approving a thrift-sponsored securities brokerage and investment advisory firm.[11]

As a result, while there was not a single bank or bank affiliate engaged in public securities brokerage at the beginning of

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9 *Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc.* (August 26, 1982).

10 *FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks*, 47 Fed. Reg. 38984 (Sept. 3, 1982). *See also* 48 Fed. Reg. 22155, *et seq.* (May 17, 1983).

11 *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, Perpetual American Federal Savings & Loan Association and California Savings & Loan Association* (May 6, 1982).

1982, more than 600 bank and thrift institutions reportedly had announced plans to enter that business by the end of that year. Hector, "The Banks Invade Wall Street," *Fortune*, February 7, 1983, at 44.

Each of these administrative actions is now subject to court challenge.[12] Congressional reaction has also been sharp. A Conference Committee to which major bank reform legislation was referred took the highly unusual step in its Report of directing the Federal Home Loan Bank Board that it:

> should not approve, in the absence of clear and specific Congressional authorization, any new regulation expanding activities of [savings and loan subsidiaries] . . .

S. Rep. No. 97-641, 97th Cong., 2d Sess. 88 (1982). The Chairman of the Senate Banking, Housing and Urban Affairs Committee publicly has described the banking agencies' regulatory changes as "go[ing] to the basic structure of our financial system." *See FDIC Schedules Hearing on Bank Securities Trading Proposal*, 40 Wash. Fin. Rep. (BNA) No. 21 at 1085 (May 23, 1983). And, the Chairman of the House Banking, Finance and Urban Affairs Committee even introduced legislation designed to impose a moratorium on the expansion of activities by all financial services institutions, which would result in BAC's having to divest itself of Schwab. H.R. 3499, 98th Cong., 1st Sess. (1983).

Nor have the recent administrative actions been limited to bank brokerage activities. For example, one bank agency has recently ruled that shares in bank-operated collective investment funds do not constitute "securities" and so may be underwritten by banks, despite this Court's contrary holding in *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971) ("*ICI*

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12 *See Securities Industry Ass'n* v. *Conover*, No. 82-2865 (D.D.C. filed Oct. 6, 1982); *Investment Co. Inst.* v. *United States*, No. 82-2532 (D.D.C. filed Sept. 8, 1982); *Securities Industry Ass'n* v. *Federal Home Loan Bank Board*, No. 82-1920 (D.D.C. filed July 12, 1982).

I").[13] Another agency has just approved the first bank-run investment advisory service to be offered in conjunction with securities brokerage for the public.[14]

All of this has been occurring even though, of course, it is Congress, and not administrative agencies, which should set national policy. As this Court recently put it in *BankAmerica Corporation* v. *United States*, 51 U.S.L.W. 4685, 4688 (June 8, 1983), policy determinations "must be implemented by Congress and not by a crabbed [administrative] interpretation of the words of the statute."

The ruling here, although not necessarily involving all of the same issues as the various rulings cited above, is a seminal agency action which has influenced the ongoing expansion of banks into securities brokerage and other nonbanking areas. Absent action by this Court, the decision below will only encourage further administrative dismantling of statutory restrictions on bank activities. Given its national significance, this case warrants review by this Court.

II.

THE COURT OF APPEALS DECISION RESOLVES IMPORTANT QUESTIONS OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS COURT

Not only is the result reached by the Court below of national significance, but the analysis adopted in doing so is equally far-ranging. By its decision, the Court of Appeals in effect sanctioned administrative redrafting of Congressionally mandated restrictions on bank activity contained in both the Bank Holding Company Act and the Glass-Steagall Act.

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13 *Decision of the Comptroller of the Currency on the Application by Citibank to Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts* (October 28, 1982).

14 *Decision of the Comptroller of the Currency Concrning an Application by American National Bank of Austin, Texas, to Establish an Operating Subsidary to Provide Investment Advice* (September 2, 1983).

A. The Court of Appeals Decision Alters Existing Statutory Restrictions on the Activities of Bank Affiliates Contained in the Bank Holding Company Act

The Bank Holding Company Act, enacted in 1956, generally prohibits bank holding companies from owning corporations engaged in any "activities other than banking", 12 U.S.C. § 1841, *et seq.* As explained by the Chairman of the House Committee on Banking and Currency, the legislation was designed to "divorce from holding companies" the power "to engage in unrelated business." 101 Cong. Rec. 8020 (1955) (remarks of Rep. Spence).[15]

The few narrow exceptions to this general restriction permitted bank affiliates to provide support activities such as owning the physical property occupied by a bank and operating a safe deposit business. *See* 12 U.S.C. § 1843(c)(1). The exception involved in this case, while less specific, was similarly understood to have a narrow focus. As enacted in 1956, it authorized only activities determined by the Board to be "so closely related to the business of banking . . . as to be a proper incident thereto." Pub. L. No. 511, § 4(c)(6), 70 Stat. 137 (1956). Senator Robertson, Chairman of the Senate Committee on Banking and Currency, and a sponsor of the original Act, explained that the purpose of the exception was to allow "holding companies to continue to carry on functions closely related to banking which are *essential* for their efficient operation." 102 Cong. Rec. 6755 (1956) (emphasis added).[16]

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15 A member of the Senate Banking and Commerce Committee explained during debate on the controversial bill:

> [M]any, many years ago Congress adopted the philosophy that banks ought not to engage in outside business. . . . [W]hat we are trying to do is bring bank holding companies within the same rules and regulations that apply to ordinary banks.

102 Cong. Rec. 6933, 6936 (1956) (remarks of Sen. Capehart).

16 *See also*, H.R. Rep. No. 609, 84th Cong., 1st Sess. 16-17 (1955) ("Your Committee has, however, exempted certain specific business which it believes to be obviously incidental to the business of banking."); S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955).

A close connection was thus required between any proposed nonbanking activity and the business of banking. As William McChesney Martin, then the Board's Chairman, testified during hearings in 1969 on proposed amendments to the Act, the "so closely related" exception required "a direct and significant connection between the proposed activities of the company acquired and the business of banking." *See* "Bank Holding Company Act Amendments," *Hearings Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess., 199 (1969) (testimony of Hon. William McChesney Martin). *See also* 116 Cong. Rec. 41959 (1970) (letter of Hon. Arthur Burns).

The Board urged Congress in 1969 to eliminate the "so closely related" test and to substitute a more flexible standard of "functionally related to banking" (*id.*), but Congress did not do so. As re-enacted in 1970, the provision required that the Board find proposed activities to be "so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).[17]

Although the Board has some latitude under Section 4(c)(8) to determine what activities comport with the "so closely related" standard, the Board does not have the latitude to rewrite the standard itself, contrary to Congressional intent. Yet, that is what has occurred. Despite the statutory language and its legislative history, the Board here did not require that

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17 While both Houses of Congress included a "functionally related" test in bills which they passed to amend the Bank Holding Company Act, the modification was deleted in Conference Committee. The only change Congress made in 1970 was to delete the words, "the business of," from the statutory phrase "closely related to [the business of] banking." This change made it permissible for a holding company affiliate to engage in activities closely related to those of banks in general, even if the specific holding company involved were not so engaged. *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46, 73, n.51 (1981). *See also* H.R. Rep. No. 1747, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Adm. News 5561, 5572; 116 Cong. Rec. 41956 (1970) (remarks of Rep. Widnall).

the proposed brokerage activity have a "direct and significant connection" with banking, or indeed any connection with banking at all. The Board instead approved the services simply because it found them "operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well-equipped to provide such services." (25a.)

The operational or functional *similarity* found sufficient by the Board is a far cry from the operational *connection* required by Congress. This is no mere matter of semantics. By administrative fiat, the Board in effect has substituted its proposed "functionally related" criterion for the statutorily required "so closely related" test—exactly what Congress refused to do in 1970. And, by deferring to the Board's approach, the court, conflicting with a decision in another Circuit (*see*, *infra*, pp. 18-19), sanctioned this exercise in administrative lawmaking.

The Court of Appeals cited this Court's decision in *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981) ("*ICI* II") in support of its conclusion that mere "functional similarity" is sufficient to satisfy Section 4(c)(8). But, in *ICI* II, the service proposed under the Bank Holding Company Act, investment advice, was a service that banks themselves concededly had performed for decades. *Id.*, 450 U.S. at 55. The proposed service therefore was not only "closely related" to banking services, it *was* a banking service. Accordingly, this Court did not need to, and did not, reach the further, significant question at issue here: the relationship required by Section 4(c)(8) between banking and a proposed activity that banks have *not* performed in the past.

There is no dispute that the retail brokerage business at issue has not previously been a banking activity. (15a-16a; 25a.) Nor is this even an instance where approval was sought for brokerage activities that facilitate or support other banking operations, such as bank trust departments. Rather, the activity approved here is to be aggressively marketed to the public in general as an independent, nonbank undertaking.

The Board's "functional similarity" rationale, now embraced by the court below, will have far-ranging consequences beyond the confines of this case. It can be used to sanction any number of nonbanking activities. That banks have the capacity to execute "wire transfers" of funds, for example, could be argued as sufficient under this standard to allow bank affiliates to enter the public telecommunications industry.[18] Even the long history of bank incentive programs, providing customers with toasters, calculators and other consumer goods, could be claimed to be enough to justify entry into the "functionally similar" activity of retail consumer sales.

In sum, absent action by this Court, the statutory language of the Bank Holding Company Act will remain turned inside out, with a narrowly drawn exception to a broad Congressional prohibition transformed administratively into an unintended and open-ended authorization.

B. The Court of Appeals Decision Alters Existing Statutory Restrictions on the Activities of Bank Affiliates Contained in the Glass-Steagall Act

The opinion below similarly sanctioned administrative rewriting of the Glass-Steagall Act and vested in the Board regulatory authority under that Act withheld by Congress. Representing Congressional reaction to the financial chaos of the late 1920's and the ensuing banking crisis of the early 1930's, the Glass-Steagall Act was a "drastic step" considered to be a "prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *ICI* I, 401 U.S. at 629, 639.

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18 Indeed, the American Bankers Association, responding recently to a Board proposal to expand its pre-approved list of nonbanking activities, requested the Board to recognize a variety of telecommunications services as now being permitted by Section 4(c)(8). *See ABA Objects to Fed's Proposed Reg Y Revision*, 41 Wash. Fin. Rep. (BNA) No. 7 at 225 (Aug. 15, 1983).

Congress did not simply regulate the securities activities of banks through the Glass-Steagall Act; it prohibited them, with only narrowly circumscribed exceptions. Both direct and indirect bank participation in the prohibited activities were covered. As described above (pp. 2-3), through Sections 16 and 21 of the Act Congress entirely prohibited banks from engaging directly in the activities, and through Sections 20 and 32 it restricted banks from indirectly doing so by either affiliation or management interlocks (53a-55a). More specifically, Section 16 of the Act restricts banks' dealing in securities to "purchasing and selling" solely as an accommodation to banking customers,[19] and Section 20 prohibits bank affiliation with any entity principally engaged in the "public sale" of securities.

Despite the established rule of statutory construction that all sections of a comprehensive statutory scheme should be read together,[20] and the concession of the Board's own counsel that the phrases "public sale" and "purchasing and selling" should be read consistently,[21] the court below concluded that the sections were not co-extensive.

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19 Contemporaneously with enactment of the Glass-Steagall Act and during the ensuing 50 years, the Comptroller of the Currency ruled that national banks were prohibited from engaging in brokerage activities except as an accommodation to customers with whom they had pre-existing banking relationships. The Comptroller's recent effort to reverse this half century of consistent administrative construction and to approve retail securities brokerage as an activity for banks is, as noted previously, now under court challenge. *Securities Industry Ass'n* v. *Conover*, No. 82-2865 (D.D.C. filed Oct. 6, 1982).

20 *E.g., N.L.R.B.* v. *Lion Oil Co.*, 352 U.S. 282, 288 (1957).

21 The Board's counsel, while contending that the proposed acquisition was not prohibited under the Glass-Steagall Act, nevertheless urged before the Administrative Law Judge in the proceedings below that the phrases, "purchasing and selling" and "public sale," were functional equivalents and as parts of a comprehensive statutory scheme should be construed consistently as encompassing brokerage. (Post-Hearing Brief of Board Counsel at 19-23).

Avoiding this Court's repeated instruction that the terms of the Glass-Steagall Act are *not* to be construed narrowly,[22] the court below concluded that the prohibition in Section 20 against bank affiliates' being principally engaged in the "public sale" of securities was to be construed according to its technical meaning. The court viewed the term as referring only to large-scale offerings undertaken for an issuer and not to purchasing and selling of securities undertaken by a broker. And, the court held that for the first time in 50 years a bank affiliate could engage principally in retail securities brokerage, even though a bank may be barred entirely from it.

The court below repeatedly cited (12a, 13a) this Court's statement in *ICI* II that the structure of the Glass-Steagall Act "reveals a Congressional intent to treat banks separately from their affiliates." 450 U.S. at 59 n.24. But, as this Court there made clear, the difference between the prohibitions of Sections 16 and 20 of the Act relate solely to the permitted *level* of securities activities for banks, as opposed to affiliates: Section 16 bars banks entirely from engaging in the prohibited activities, while Section 20 bars bank affiliates only from engaging principally in such activities. Nowhere did this Court suggest that the two sections were aimed at different *types* of activities. Indeed, in *ICI* I, 401 U.S. at 626, n.12, this Court had expressly noted the congruity of the terms used in the sections of the Act that bar indirect securities activities and the sections that bar securities activities directly:

> The limitations that the banking laws place on the activities of national banks are at least as great as the limitations placed on the activities of their affiliates. For example, § 32 refers to the "public sale" of stocks or securities while § 21 proscribes the "selling" of stocks or securities.

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22 *See ICI* II, 450 U.S. at 65; *ICI* I, 401 U.S. at 635; *Board of Governors* v. *Agnew*, 329 U.S. 441, 446-47 (1947); *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935) (construing the term "without recourse" used in the McFadden Act and reenacted as part of the Glass-Steagall Act). Indeed, the court below also gave the term, "without recourse", an inappropriately narrow reading. (13a, n.4.)

The court below also sought support for its holding in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), concluding that this Court had implicitly determined the present issue in that action. However, *Agnew* was a case concerning Section 32 of the Act, in which this Court did not, and did not have to, reach the question of whether brokerage activities are prohibited for banks or whether the term "public sale" should be construed consistently with the term "purchasing and selling" used elsewhere in the Act. This Court certainly did not rule in *Agnew* that bank affiliates may engage principally in activities that are prohibited entirely for banks.

The view of the court below in the latter respect was as follows (12a):

> We think, however, that the latitude the Act grants bank holding companies partially to engage in activities such as underwriting, which implicate the Act's policies whether conducted by banks or bank holding companies, suggests that bank holding companies can, under the Act, be allowed principally to engage in activities which pose the dangers the Act addressed only when conducted by banks.

This conclusion was unaccompanied by citation, because it marks the first time any court has ruled that the coverage of Section 20 depends upon an assessment of whether the activities involved "pose the dangers the Act addressed". By this unprecedented ruling the Court, in effect, vested in the Board regulatory authority to exempt activities from coverage of Section 20 depending upon the Board's view of the risks involved. The court thereby changed the Section from the prohibitory statute intended by Congress to a regulatory Act that permits administrative exceptions to its otherwise flat prohibitions, and adopted a rationale that could be used to except any number of securities activities from its restrictions.[23]

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23 In marked contrast with Section 32 of the Act, which permits the Board to exempt certain arrangements from the Act's management interlock provisions, Section 20 vests *no* exemptive authority whatsoever in the Board to authorize bank securities activities.

In short, the decision below under the Glass-Steagall Act, like the decision under the Bank Holding Company Act, has far-reaching implications. It, too, warrants review by this Court to avoid the uncertainty and litigation that inevitably will otherwise result.

III.

THERE IS A DIRECT CONFLICT BETWEEN THE CIRCUITS AS TO THE ACTIVITIES THAT BANK AFFILIATES ARE PERMITTED TO CONDUCT UNDER FEDERAL LAW

As discussed above (pp. 11-14), the administrative construction of Section 4(c)(8) of the Bank Holding Company Act affirmed by the court below rejects any requirement that the activities of bank affiliates, not traditionally performed by banks, must be limited to those that facilitate or support authorized bank activities. (18a.) Rather, the Board's ruling found mere "functional similarity" between proposed non-banking activities and banking to be sufficient. By affirming this standard, the decision below conflicts with the prior interpretation of Section 4(c)(8) by the Fifth Circuit Court of Appeals.

In *Alabama Association of Insurance Agents* v. *Board of Governors*, 533 F.2d 224 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978), the Fifth Circuit refused to adopt the unlimited "functional similarity" standard accepted here. In reviewing a regulation adopted by the Board permitting bank affiliates to engage in a variety of insurance brokerage activities, the court there held that Section 4(c)(8) permitted only those activities where there was demonstrated a "direct relationship" between the insurance brokering and "an extension of credit or other financial services," *id.* at 240, where the brokering was "helpful, and perhaps essential, to the success of the [banking] enterprise," *id.* at 241, or where the insurance brokering was

undertaken specifically on behalf of a *bank*. *Id.* The Fifth Circuit rejected the proposition that a bank affiliate could engage in other, *functionally identical* insurance brokering activities because they did not "contribute to the operations of those subsidiaries actually engaged in the banking business." *Id.*

Thus, the "functional similarity" test adopted by the Second Circuit here was rejected by, and conflicts with, the holding of the Fifth Circuit.[24] In order to resolve the consequent and significant uncertainty created, this Court should exercise its supervisory power to review the decision below.

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24 Nor does the decision in *National Courier Association* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975), cited both by the Board (24a) and the Court of Appeals (14a), support the rationale adopted below. In the *National Courier* case the court found that courier activities involving materials other than financial data and offered to the general public were not even properly "incidental" to an activity that was closely related to banking, let alone "closely related" themselves to a banking activity. 516 F.2d at 1241. And, that was so even though the proposed public courier activities were functionally identical to courier services otherwise found to be proper for banks.

CONCLUSION

For all and each of the foregoing reasons, this Court should issue a Writ of Certiorari to review the judgment and opinion of the Second Circuit Court of Appeals.

Dated: October 13, 1983
New York, New York

Respectfully submitted,

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No. 83-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 83-4019

Argued: May 23, 1983

Decided: July 15, 1983
(as amended September 20, 1983)

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—against—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents,

—and—

BANKAMERICA CORPORATION,

Intervenor.

Appearances

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Before:

FEINBERG, *Chief Judge*,
LUMBARD and WINTER, *Circuit Judges*.

LUMBARD, *Circuit Judge*:

On January 7, 1983 the Federal Reserve Board authorized the BankAmerica Corporation, a bank holding company, to acquire the Charles Schwab Corporation, the sole owner of Charles Schwab & Co., the nation's largest "discount" brokerage firm. The Securities Industry Association (SIA), a national trade association representing over 540 securities brokers,

dealers, and investment banking companies, petitions for judicial review of the Board's order. SIA contends that the acquisition approved by the Board violates both the Glass-Steagall Act and the Bank Holding Company Act. We find, however, that neither of those Acts prohibits a bank holding company from engaging in retail brokerage, and that the Board acted well within its discretion in approving BankAmerica's application. We therefore deny SIA's petition for review and affirm the order of the Board.

The BankAmerica Corporation (BAC), with total assets of $120.5 billion, is the second largest bank holding company in the United States. BAC's most important subsidiary is the Bank of America (Bank) which, with domestic deposits of $52 billion, is the nation's largest commercial bank. Charles Schwab & Co. (Schwab) is principally engaged in retail securities brokerage. Schwab buys and sells securities solely as agent, on the order and for the account of its customers. Schwab offers its brokerage customers incidental services including margin loans, securities custodial services, and "sweep" accounts in which net balances awaiting investment are deposited in a money market fund not affiliated with Schwab. Schwab does not, however, offer its customers investment advice and, with minor exceptions not here relevant, does not underwrite or deal in securities. Schwab and similar firms are called "discount brokers" because the commissions they charge typically are significantly lower than those charged by full-service brokerage firms which offer investment advice. Schwab, headquartered in San Francisco, operates nationwide with offices in 26 states and the District of Columbia. Although, by revenue, Schwab currently holds 9% of the discount brokerage market, it holds less than 1% of the total retail brokerage market.

On March 8, 1982 BAC applied to the Federal Reserve Board for permission to acquire 100% of the stock of Schwab's parent corporation. BAC filed its application under § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1976), which authorizes the Board to approve a bank holding company's acquisition of a subsidiary if the subsidiary's activities are "closely related" to banking and if

the public benefits reasonably to be expected from the acquisition outweigh possible adverse effects. The Board published notice of BAC's application in the Federal Register, 47 Fed. Reg. 16,104 (1982), and requested comments from interested parties. The Antitrust Division of the Department of Justice, the Comptroller of the Currency, and the Securities and Exchange Commission all filed comments in support of the application. SIA opposed the application and requested the Board to conduct a formal hearing. An administrative law judge held an evidentiary hearing in September, 1982, and on November 12, 1982, issued his decision recommending that the acquisition be approved. The judge found the proposed acquisition to be consistent with both the Glass-Steagall Act and the Bank Holding Company Act. On January 7, 1983 the Board adopted the judge's findings and conclusions, with modifications, and authorized BAC to acquire Schwab. 69 Fed. Res. Bull. 105 (1983). SIA petitions for review under 12 U.S.C. § 1848 (1976).

I. *Glass-Steagall Act*

Those provisions of the Banking Act of 1933 that mandated a separation of the commercial and investment banking industries are known as the Glass-Steagall Act. *See* Pub. L. No. 73-66, §§ 16, 20, 21, & 32, 48 Stat. 162 (1933). SIA claims that the Glass-Steagall Act prohibits bank holding company subsidiaries from conducting a retail brokerage business. Although SIA's claim raises an issue of law which we have the ultimate responsibility to decide, *see* 5 U.S.C. § 706 (1976), the Board's thorough opinion rejecting the claim is entitled to substantial deference. Because the Board has both primary responsibility for implementing the Glass-Steagall Act and expert knowledge of commercial banking, we must uphold its interpretation of the Act if it is reasonable. *See Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21 (1981), quoting *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, *J.*, concurring); *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-27 (1971); *A.G. Becker Inc.* v. *Board of Governors*, 693

F.2d 136, 140-41 (D.C. Cir. 1982). We conclude that the Board's interpretation was reasonable and entirely consistent with the Act's language and policy.

Only one of the Glass-Steagall Act's four provisions is directly applicable to bank holding companies. That provision, § 20, 12 U.S.C. § 377 (1976) states:

> [N]o member bank shall be affiliated in any manner . . . with any corporation, association, business trust, or other similar organization *engaged principally in the issue, flotation, underwriting, public sale, or distribution* at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities . . .

(emphasis supplied). As a bank holding company's various subsidiaries are bank affiliates for purposes of § 20, *see* 12 U.S.C. § 221a(b) (1976), BAC's acquisition of Schwab will make Schwab an affiliate of Bank. Section 20 therefore prohibits the acquisition if Schwab is "engaged principally" in any of the activities listed in the statute. Although SIA concedes that Schwab is not engaged in the issue, flotation, underwriting, or distribution of securities, it argues that Schwab's retail brokerage business does constitute the "public sale" of securities.

SIA's interpretation of "public sale" to include brokerage is rebutted by the "familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third Natl. Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977) (footnote omitted). *See also General Elec. Co.* v. *OSHA*, 583 F.2d 61, 65 (2d Cir. 1978). The terms "issue," "flotation," "underwriting," and "distribution" all refer to the widespread marketing of specific issues of new securities in which the dealer trades as principal for his own profit. *See generally* L. Loss, Securities Regulation 159-72 & 547-53 (2d ed. 1961). Such activities greatly differ from retail brokerage, in which the broker trades as an agent for commission, not as a principal for profit, and does not transfer title. Thus if "public sale" is to be given a meaning similar to that of the terms that surround it, it cannot be read to encompass retail brokerage.

Moreover, if Congress had intended § 20 to cover brokerage, it presumably would have used words more precise than "public sale." Section 16 of the Act, 12 U.S.C. § 24(7) (1976), authorizes banks to engage in "purchasing and selling . . . securities and stocks without recourse, solely upon the order, and for the account of, customers." Congress' use in § 16 of language that specifically refers to brokerage,[1] and its omission of similar terms from § 20, suggests that Congress did not intend § 20 to cover brokerage. *See FTC* v. *Sun Oil Co.*, 371 U.S. 505, 514-15 (1963) (terms carefully employed by Congress in one place, and excluded in another, should not be implied where excluded).

The Board's ruling that § 20 does not encompass brokerage is supported by its long-standing interpretation of a different provision of the Glass-Steagall Act, § 32, 12 U.S.C. § 78 (1976). Section 32 prohibits managerial or other interlocks between member banks and any entity primarily engaged in "the issue, flotation, underwriting, public sale, or distribution" of securities. Section 32's list of prohibited activities is precisely that found in § 20. In January, 1936, shortly after the Banking Act of 1935 revised § 32 into its present form, the Board ruled that "[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32." 22 Fed. Res. Bull. 51 (1936). The Board's interpretation of § 32, to which it still adheres, *see* 12 C.F.R. § 218.1 n.1, has been confirmed by the Supreme Court. In *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), two directors of a national bank also worked for a securities firm which derived approximately 32% of its gross income from underwriting, and 42% from brokerage. The Board ruled that the directors' outside firm was "primarily engaged" in activities covered by § 32, and it ordered the directors to resign from the bank. The directors challenged the Board's order in court. The District of Columbia Court of Appeals, by a divided vote, held that an injunction should issue. 153 F.2d 785 (1946). The

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1 The scope of the brokerage activities which § 16 authorizes banks to conduct is open to debate. *See infra.*

majority and dissenting opinions in the Court of Appeals agreed that § 32 does not cover brokerage. 153 F.2d at 790, 795. They disagreed only on the degree of involvement necessary for a firm to be "primarily" engaged in an activity prohibited by § 32. The Supreme Court granted certiorari and reversed. The Court concluded, as had the dissenting judge in the Court of Appeals, that a firm is "primarily" engaged in a prohibited activity if it is "substantially" so engaged, and that the Board's order was therefore lawful notwithstanding the fact that the directors' outside firm earned less than half of its revenue from underwriting. Although the Court did not explicitly rule brokerage to be excluded from § 32, it did distinguish the firm's brokerage income from its underwriting income, and used the language of § 32 to define "underwriting" as the "issue, flotation, underwriting, public sale or distribution" of securities. 329 U.S. at 445 n.3. It thus seems clear that the Court read § 32 to exclude brokerage. Indeed, if the Court had not so read the statute, it would not have had to explore the meaning of "primarily engaged," since the directors' outside employer was, under any interpretation of the term, "primarily engaged" in underwriting and brokerage taken together. Use of the same language in different statutory provisions, where the various provisions were enacted together and concern the same general goals, is a strong indication that Congress intended the language to have the same meaning wherever it appears. *See Northcross* v. *Board of Educ. of the Memphis City Schools*, 412 U.S. 427, 428 (1973); *Hargrave* v. *Oki Nursery, Inc.*, 646 F.2d 716, 720 (2d Cir. 1981). The Board's consistent interpretation excluding brokerage from § 32 is thus, especially in view of *Agnew*, strong evidence that brokerage is excluded from § 20.[2]

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2 Also significant is the Supreme Court's comment in *Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 58 n.24 (1981), that § 20 prohibits bank ownership of securities affiliates that are engaged principally "in the issuance or underwriting of securities." The Court's failure to include "brokerage" in the list of activities covered by § 20 is a further suggestion that brokerage is excluded from the statute.

The policies behind the Glass-Steagall Act shed further light on the proper interpretation of § 20. Congress intended the Act to address two principal concerns. First and foremost, Congress believed that commercial bank involvement in underwriting and securities speculation had unduly placed bank assets at risk and had contributed to "the widespread bank closings that occurred during the Great Depression." *Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 61 (1981) (footnote omitted). Securities trading had impaired bank solvency not only directly through bad investments by banks, but also indirectly through the unsound banking practices that securities trading promoted. In particular, Congress recognized that a bank trading for its own account has a "salesman's interest" that is inconsistent with the traditional role of banks as impartial extenders of credit. A bank seeking to sell the stock of a particular company might, for example, extend customers credit to be used for purchase of the stock or might grant the company an unsound loan simply to improve the stock's marketability. *See Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 631 (1971). Similarly, a bank that engages in trading through a securities affiliate might improperly extend credit to the affiliate, or to companies in which the affiliate invested, in order to avoid the loss in public confidence it would experience if the affiliate failed. Securities trading further shakes public confidence in banks because it associates banks with speculative ventures, and because some customers purchasing securities on bank representations will inevitably suffer losses. This loss of public confidence poses an additional threat to bank solvency. *See id.*, 401 U.S. at 631-32. Thus in strictly limiting the right of commercial banks to trade in securities, Congress sought to ensure bank solvency, to protect bank depositors, and to maintain public confidence in the nation's banks. Second, Congress recognized the inherent conflict between the promotional role of an investment banker and the commercial banker's obligation to give disinterested investment advice. A commercial bank that trades as a principal might allow its interest in trading profits to override the fiduciary duties owed to depositors. *See id.*, 401 U.S. at 633. Congress thus intended

the Glass-Steagall Act to guarantee that the impartiality of investment advice would not be "tainted by a desire to profit from the promotion of one particular security over another." Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L.J. 102, 104 (1981) (footnote omitted).

Schwab's brokerage services do not present any of the dangers which the Glass-Steagall Act was designed to forestall. Because Schwab trades only as an agent, and never as a principal, its assets are not subject to the risks of the securities markets. Equally important, Schwab's lack of a "salesman's interest" in the securities it trades eliminates the incentive for the Bank to engage in promotional activities. Schwab's revenue depends solely on the volume of shares traded, and is not dependent upon the sale or purchase of specific securities. Thus the Bank cannot increase Schwab's profits by extending credit to securities issuers to bolster their stock or to purchasers for the purchase of specific shares, or by improperly favoring particular securities in its management of customers' assets. Although Schwab and the Bank will be associated with one another in the public eye, the losses that some customers will sustain on trades executed through Schwab will be unlikely to impair public confidence in the Bank. Given Schwab's strict policy not to offer investment advice, customers who trade unsuccessfully will have only themselves, and not Schwab or the Bank, to blame for their mistakes.

The Act's legislative history and Supreme Court precedent support our interpretation of the Act's focus. First, the legislative history, though it discusses at length the dangers posed by commercial bank involvement in underwriting and securities speculation, *see*, *e.g.*, S. Rep. No. 77, 73d Cong., 1st Sess. 8-10 (1933), makes but passing reference to bank brokerage activity. The Senate report states only that the Act allows banks to "purchase and sell investment securities for their customers to the same extent as heretofore." *Id.* at 16. This statement hardly suggests that brokerage was one of Congress' principal concerns. Second, in *Investment Co. Inst.* v. *Camp*, *supra*, the Supreme Court drew a clear distinction between brokerage and activities in which a bank trades as a principal. In *Camp*, the

Court held that a bank's plan to distribute shares in a bank-managed open-end investment fund would constitute an impermissible underwriting of securities in violation of § 16 of the Act. The Court emphasized that the bank would have a salesman's stake in the fund's shares, and thus would have an incentive to engage in promotional activities contrary to the Act's policy. The Court contrasted the bank's plan with brokerage services, and stated that the hazards associated with promotional activities "are not present when a bank undertakes to purchase stock for the account of its individual customers." 401 U.S. at 638. The Court stated that purchases on account "do not give rise to a promotional or salesman's stake in a particular investment; . . . do not entail a threat to public confidence in the bank itself; . . . and do not impair the bank's ability to give disinterested service as a fiduciary or managing agency." *Id.* The Court's comments, though dicta, strongly suggest that Congress did not intend § 20 to prohibit bank affiliates from engaging in retail brokerage. *See also New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091, 1099-1100 (D.D.C. 1975) (bank's plan to purchase securities on account for customers, and automatically to deduct designated purchase amount from customers' bank accounts, held to be consistent with the Act), *vacated on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

We thus find the Board's ruling to be supported by both the language of § 20 and the Act's policy. SIA argues, however, that § 20's true meaning cannot be found without reference to § 16 of the Act, 12 U.S.C. § 24(7) (1976), which defines the extent to which commercial banks may trade in securities. Section 16 states, in pertinent part, that:

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account.

Although SIA concedes, as indeed it must, that § 16 is directly applicable only to banks, and not to bank holding companies, *see Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46,

58 n.24 (1981), it argues that §§ 16 and 20 must be interpreted "consistently," and cannot be read to permit bank holding companies a broader degree of brokerage activity than is allowed to banks. SIA contends that § 16 does not authorize banks to conduct retail brokerage businesses such as Schwab's. SIA's position is supported by certain early rulings by the Comptroller of the Currency which held that § 16 authorizes a bank to engage in brokerage only if (1) the customer has a customer relationship with the bank independent of the brokerage transaction, (2) the bank offers its brokerage services at cost, and (3) the customer makes prior payment or has assets at the bank sufficient to cover his transaction. *See e.g.*, 1 Bulletin of the Comptroller of the Currency, No. 2 at 2-3 (1936). Relying principally upon the Comptroller's rulings, SIA argues that banks may engage in brokerage only to accommodate existing customers, and that the principal brokerage activities of bank holding companies must, under a consistent interpretation of the Act, be similarly limited.

The proper interpretation of § 16 is before us only incidentally, and we do not think it necessary to explore the question in detail. Instead, three considerations convince us that SIA's attempt to transfer the focus of this case from § 20 to § 16 is unavailing. First, the Comptroller of the Currency recently reversed the rulings upon which SIA relies. In *Security Pacific Natl. Bank*, [Current] Fed. Bank. L. Rep. ¶ 99,284 (CCH) (1982), the Comptroller held that § 16 authorized a national bank to establish a subsidiary that would offer discount brokerage services to the public but would not offer investment advice. The Comptroller stated that his earlier restrictive rulings reflected "the great caution of banking regulations in the years immediately following the 1931-32 debacle," and were not supported by either the purposes or the express language of the Glass-Steagall Act. Because we agree with the Comptroller that the Act's policies are not contravened by bank participation in retail brokerage, we are inclined to give significant weight to the Comptroller's repudiation of his earlier rulings.[3]

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3 SIA has brought an action in the District Court for the District of Columbia challenging the Comptroller's ruling in *Security Pacific*

Second, SIA has not convincingly explained why §§ 16 and 20, notwithstanding Congress' use of very different language in the two provisions, must be interpreted alike. If, as SIA contends, Congress intended in §§ 16 and 20 significantly and equivalently to restrict the brokerage activities of banks and bank holding companies, it presumably would have used the same, or at least similar, language in both statutes. Finally, the structure of the Act "reveals a congressional intent to treat banks separately from their affiliates," *Investment Co. Inst.*, *supra*, 450 U.S. at 59 n.24, and clearly indicates that the same prohibitions do not apply to both. Banks, for example, under § 16 can never underwrite or deal in the securities of private issuers, while bank holding companies, under § 20, can engage in such underwriting and dealing so long as they are not principally so engaged. SIA argues that this distinction between §§ 16 and 20 is unimportant; that the same *types* of activities are prohibited to banks and to bank holding companies; and that bank holding companies, even if they can partially engage in certain activities totally barred to banks, cannot principally engage in such activities. SIA thus concludes that § 20 at most authorizes Schwab minimally to engage in retail brokerage, and does not allow it to make brokerage a principal line of business. We think, however, that the latitude the Act grants bank holding companies partially to engage in activities such as underwriting, which implicate the Act's policies whether conducted by banks or by bank holding companies, suggests that bank holding companies can, under the Act, be allowed principally to engage in activities which pose the dangers the Act addressed only when conducted by banks. Congress clearly intended the Act to restore banking as the principal business of banks, and may have believed (though we see no support for the point in the legislative history) that banks would be unreasonably diverted from banking by participation in retail brokerage. But even if Congress, because of

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Natl. Bank. Securities Industry Assoc. v. *Conover*, No. 82-2865 (D.D.C. filed October 6, 1982). What we say here is not meant to express an opinion on the validity of the Comptroller's ruling.

such concerns, restricted in § 16 the brokerage activities allowed to banks, no similar danger of diversion is posed by the brokerage activities of bank holding companies. Thus even if § 16 prohibits banks from acting as retail brokers, we would have to conclude, in light of (1) the statutory language and policy considerations previously discussed and (2) the Act's clear intent to "treat banks separately from their affiliates," that Congress did not intend § 20 to prohibit bank holding companies from acquiring or establishing brokerage subsidiaries.[4]

II. *Bank Holding Company Act*

The Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.* (1976), generally prohibits bank holding companies from engaging in nonbank activities. However, section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), provides that a bank holding company may acquire:

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4 SIA also argues that the Board's order contravenes the provision of § 16 that limits national banks to "purchasing and selling such securities and stock without recourse. . . ." SIA contends that Schwab trades "with recourse" because brokerage customers occasionally "walk away" from trades that prove unprofitable within the settlement period, leaving Schwab liable to the third party to the transaction for the purchase price or for delivery of the security. Beyond the fact that SIA has not convinced us to incorporate § 16's language into § 20, we do not think that Schwab's activities violate § 16 merely because it faces the kind of incidental liability to which SIA refers. The Supreme Court's decision in *Awotin* v. *Atlas Exchange Natl. Bank of Chicago*, 295 U.S. 209, 212 (1935) (holding that a repurchase agreement between the bank and one who bought bonds from it was void as a violation of § 16), strongly suggests that the limitation in § 16 is directed against endorsement or guaranty contracts "by which the bank assumes the risk of loss which would otherwise fall on the buyer of securities, or undertakes to insure to the seller the benefit of an increase in value of securities which would otherwise accrue to the Bank." Schwab does not enter into contracts that obligate it to "assume" ultimately its brokerage customers' risks; on the contrary, it retains full power to bring actions for breach of contract against customers who fail to pay for or deliver securities.

> shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Section 4(c)(8) further provides that:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern.

Section 4(c)(8) authorizes the Board to approve a bank holding company's acquisition of a nonbank subsidiary only if it determines that (1) the subsidiary's activities are "closely related" to banking, and (2) the public benefits reasonably to be expected from the acquisition will outweigh possible adverse effects. *See* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. (1970) *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5572-73. *See, e.g., Independent Ins. Agents of America, Inc.* v. *Board of Governors*, 658 F.2d 571, 573 (8th Cir. 1981); *Citicorp* v. *Board of Governors*, 589 F.2d 1182, 1190 (2d Cir.), *cert. denied*, 442 U.S. 929 (1979); *National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1232-33 & n.2 (D.C. Cir. 1975). SIA challenges the Board's ruling that BAC's acquisition of Schwab satisfies both of these requirements.

Section 4(c)(8) and its legislative history do not identify the factors the Board is to consider in determining which activities are closely related to banking. However, in *National Courier*

Assn., *supra*, 516 F.2d at 1237, the District of Columbia Court of Appeals held that the Board may treat any activity as one closely related to banking if there is present one or more of the following connections between the activity and the business of banking:

> 1. Banks generally have in fact provided the proposed services.
>
> 2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> 3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

Although the factors listed in *National Courier Assn.* do not exhaust the possible connections which could establish a close relationship between a proposed activity and banking, *see id.*, they do usefully elucidate the closely related standard and have been employed by several of the courts of appeals, *see NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549 (7th Cir. 1978); *Alabama Assn. of Ins. Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), and by the Board. *See, e.g.*, *Citicorp*, 68 Fed. Res. Bull. 505 (1982).

In this case the Board, relying upon the second of the *National Courier Assn.* factors, held that the present securities activities of banks are operationally or functionally so similar to brokerage that banks are particularly well equipped to act as retail brokers. The Board found that many banks, as an accommodation to their customers, transmit to brokers customer orders to buy or sell securities, and that the trading desks of bank trust departments routinely buy and sell securities as agents for trusts and other accounts. The Board noted one principal difference between the securities activities of brokerage houses and of banks: brokerage houses trade listed

securities directly on the exchanges, while banks historically have employed intervening brokers to execute such trades, but it concluded that banks nonetheless have expertise in the methods of securities trading. The Board found that banks, when trading unlisted securities, often deal directly with dealers or other third parties, and that such trades require banks to "exercise the same type of discretion and judgment with respect to the best method of execution that brokers do with respect to similar types of orders." The Board further found that when banks employ intervening brokers, they often direct the broker on the best method of execution, and leave to the broker only the technical execution of the transactions. Finding that banks widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading, the Board held that retail brokerage is an activity closely related to banking.

The Board's factual findings are conclusive if supported by substantial evidence, 12 U.S.C. § 1848, and the Board's findings on bank trading activities are clearly so supported. SIA, however, argues that the Board misapprehended the legal standard implicit in the closely related test. SIA claims that an activity is closely related to banking only if it facilitates actual banking practices[5] and can be conducted by most of the

5 As enacted in 1956, § 4(c)(8) (then § 4(c)(6)) authorized bank holding companies to engage in activities "of a financial, fiduciary, or insurance nature . . . which the Board . . . has determined to be so closely related to *the business of banking* . . . as to be a proper incident thereto." Pub. L. No. 511, § 4(c)(6), 70 Stat. 137 (1956). The Board interpreted the phrase, "the business of banking," to prohibit bank affiliation with any company whose activities were not directly related to the banking operations that the particular holding company was already engaged in. Congress in 1970 deleted the words "the business of" in order to make it clear that the acquired company's activities need not be closely related to the acquiring holding corporation's specific banking business, but only to banking generally. *See* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5567; *National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1236 (D.C. Cir. 1975). SIA thus argues that § 4(c)(8) required the Board to find that retail brokerage facilitates banking generally, and does not argue that facilitation of BAC's particular banking operations is required.

nation's banks. SIA argues that brokerage does not satisfy either of those requirements, and is therefore not closely related to banking. We do not agree.

SIA's challenge to the Board's legal conclusion must be evaluated in light of the deference ordinarily due to Board determinations under § 4(c)(8). Congress has committed to the Board primary responsibility for the administration of the Act. The Board, moreover, has expertise in commercial bank regulation that the courts do not have, and it must be allowed reasonable latitude in its application of the Act to the changing activities of banks. For these reasons the Board's determination that brokerage is closely related to banking "is entitled to the greatest deference," *Investment Co. Inst.*, *supra*, 450 U.S. at 56 (footnote omitted), and may be overturned only if unreasonable or inconsistent with Congressional intent. *See National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975). We see nothing in SIA's arguments that would justify reversal of the Board's order under this standard of review.

SIA's claim that an activity must facilitate actual banking practices to be closely related to banking is, we think, refuted by the Supreme Court's decision in *Investment Co. Inst.*, *supra*. In *Investment Co. Inst.*, the Supreme Court upheld a Board regulation issued under § 4(c)(8) that authorized bank holding company subsidiaries to serve as investment advisers to closed-end investment companies. An investment company offers small investors portfolio diversification and expert management by pooling their resources under the guidance of one manager. Investment advisers are independent of the investment companies they advise. In return for a management fee, an investment adviser selects the investment company's portfolio and supervises most aspects of its business. In affirming the Board's determination that investment advisory services are closely related to banking, the Court emphasized that such services "are not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. The Court stated that the principal duty of an investment adviser is to manage the investment portfolio of its client, and noted that

banks, in their roles as executors, trustees, and managing agents, have for decades provided equivalent management services to bank customers. *Id.* The Court's analysis thus focused upon the relationship of investment advisory services to services traditionally performed by banks. The Court upheld the Board's regulation because the proposed activity constituted, in effect, the provision in a nonbanking context of services that banks have traditionally offered their customers. The Court never considered whether investment advisory services provided to nonbank investment companies facilitate actual banking practices, and it seems quite clear that they do not. Thus both the result reached in *Investment Co. Inst.*, and the analysis the Court employed, indicate that an activity need not facilitate banking practices to be closely related to banking.

SIA also contends that an activity, to be closely related to banking, must be open to most banks. SIA argues that only the largest banks have the skills and resources needed to engage in retail brokerage; that banks *generally* will not be able to enter the brokerage business; and that brokerage is therefore not closely related to banking. SIA's argument ignores the Board's express finding "that the use of sophisticated techniques, resources and personnel to execute orders for the purchase or sale of securities for the account of customers is sufficiently widespread in the banking industry to justify a finding that banks generally provide securities execution services that equip them to offer the type of retail brokerage services provided by Schwab." In any event, even if the Board had found to the contrary, we could not accept SIA's conclusion. The closely related standard does not require proof that banks generally will be able to perform the proposed service, but instead principally concerns whether the proposed service is functionally related to the traditional services banks generally have performed. The interpretation SIA gives the Act would effectively preclude the nonbank affiliates of bank holding companies from providing financial services not open to the smallest banks. We see nothing in the legislative history to suggest that Congress intended the closely related standard so greatly to

restrict innovation in the financial industry. *Cf.* H.R. Conf. Rep. No. 1747, *supra*, 1970 U.S. Code Cong. & Ad. News at 5568 ("One of the asserted justifications for permitting bank holding companies to engage in activities that the Board has determined independently to be closely related to banking, is to permit the introduction of new innovative and competitive vigor into those markets which could benefit therefrom."). An inability of banks generally to engage in a proposed activity may, of course, raise questions of competitive effect or undue concentration of resources, but such questions are appropriately resolved under § 4(c)(8)'s public benefits test and not under the closely related standard.

Finally, SIA challenges the Board's determination that the public benefits reasonably to be expected from BAC's acquisition of Schwab will outweigh the possible adverse effects. We see no basis for disturbing the Board's conclusion. As the Fifth Circuit has recognized, *see Alabama Assn. of Ins. Agents*, *supra*, 533 F.2d at 246, Board determinations under the public benefits test necessarily involve some speculation, and should be upheld if reasonable. The Board's ruling here plainly is reasonable.[6] SIA further argues that the Board erred in failing

6 The Board found that a number of public benefits are likely to result from BAC's acquisition of Schwab. The Board found that the acquisition will strengthen Schwab as a competitor by affording it access to BAC's managerial, financial, and technical resources. Noting that Schwab competes primarily on the basis of price, the Board stated that the strengthening of Schwab could induce full-line brokers to engage in greater price competition. The Board found that Schwab's affiliation with BAC, a large, internationally-known financial services company, should increase public confidence in Schwab and in discount brokers generally. Because discount brokers have been hampered by a lack of public awareness and acceptance of their services, increased public confidence in discount brokers should enhance their ability to compete against better-known firms. Finally, the Board found that Schwab's affiliation with BAC will increase consumer convenience. For example, Schwab offices operated at branches of the Bank will reduce consumer search costs by enabling consumers to obtain a broader range of financial services at a single location than is now possible. The Board found that the acquisition is unlikely to have any significant adverse effects, such as undue concentration of resources, decreased competition, or unfair competitive practices.

to require de novo entry by BAC into the retail brokerage business. Section 4(c)(8) states that in orders under the statute "the Board *may* differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern." (emphasis supplied). Congress included this language in § 4(c)(8) because it believed that de novo entry generally has greater procompetitive effect than does entry through the acquisition of an existing competitor. *See* S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5519, 5534; H.R. Conf. Rep. No. 1747, *supra*, 1970 U.S. Code Cong. & Ad. News at 5568. SIA argues that, because many of the benefits expected to result from BAC's acquisition of Schwab could equally be achieved through de novo entry by BAC into retail brokerage, the Board must require de novo entry. We do not agree. Congress did not favor de novo entry as a goal in itself, but as a means of maximizing the procompetitive effects of activities conducted under § 4(c)(8). Here, the Board found that BAC's acquisition of Schwab will not substantially lessen competition, and will likely produce public benefits that outweigh possible adverse effects. Where, as here, entry by acquisition promotes competition as effectively as would de novo entry, and involves no significant anticompetitive effects that de novo entry would avoid, the Board has discretion to permit entry by acquisition.

The petition for review is denied; the order of the Board is affirmed.

THE FEDERAL RESERVE SYSTEM

BankAmerica Corporation

Order Approving Acquisition of Retail Discount Brokerage Firm

BankAmerica Corporation, San Francisco, California ("BAC"), a bank holding company within the meaning of the Bank Holding Company Act (the "BHC Act"), has applied for the Board's approval under section 4(c)(8) of the Act (12 U.S.C. § 1843(c)(8)) and section 225.4(b)(2) of the Board's Regulation Y (12 C.F.R. § 225.4(b)(2)) to acquire 100 percent of the voting shares of The Charles Schwab Corporation, San Francisco, California, a company that engages, through its wholly-owned subsidiary, Charles Schwab & Co., Inc. ("Schwab"), in retail discount securities brokerage, extending margin loans, and other incidental activities. None of the proposed activities is among those that the Board has designated in Regulation Y as being closely related to banking and thus permissible for bank holding companies under section 4(c)(8) of the Act.

Notice of the application, affording interested parties an opportunity to submit comments and views, was duly published in the *Federal Register.* In response to its request for comments on this application, the Board received 17 written comments opposing the acquisition, and 82 favoring the acquisition, including comments from the Department of Justice, the Comptroller of the Currency, and the Securities and Exchange Commission. Among the comments opposing the proposal were those of the Securities Industry Association (the "SIA"), a national trade association representing over 540 securities brokers, dealers, and investment banking organizations. The SIA requested that the Board either deny, or order a formal hearing on, BAC's application.

On July 6, 1982, the Board issued an order scheduling a formal public administrative hearing on BAC's proposal. The

Board's hearing order observed that, while the questions raised by the various comments and protests to BAC's application might appropriately be resolved through additional written submissions, a formal hearing would provide an appropriate and expeditious method for developing a full record for Board consideration of any disputed material facts. The Board's order established an expedited briefing and hearing schedule. With the consent of the parties to the hearing, the United States Department of Justice was permitted to intervene as a party by order dated August 20, 1982.

A formal public administrative hearing, conducted in accordance with the Board's Rules of Practice for Hearings (12 C.F.R. Part 263), was held on September 8, 9, 10, 14, 15, and 16, 1982, in Washington, D.C., before an Administrative Law Judge appointed at the request of the Board. A substantial record on the application was developed through the submission of exhibits and testimony and through the participation of the SIA, BAC, the Department of Justice, and other interested parties.

In a Recommended Decision dated November 12, 1982, Administrative Law Judge Ernest G. Barnes concluded, based upon the evidence of record, that BAC's application met the criteria of section 4(c)(8) of the Act and, accordingly, recommended that the Board approve the application without condition. The SIA and BAC timely filed exceptions to the Administrative Law Judge's Recommended Decision.

Having carefully considered the entire record of the proceeding, including the comments received, and the transcript, exhibits, written testimony, rulings, and briefs filed in connection with the hearing, the Recommended Decision filed by the Administrative Law Judge, together with the exceptions thereto, the Board has determined that the Administrative Law Judge's findings of fact, conclusions, and recommendations, as modified and supplemented herein, are fully supported by the evidence of record and should be adopted as the findings and conclusions of the Board.

BAC, with total consolidated assets of $120.5 billion is one of the two largest banking organizations in the United States.[1] BAC operates one subsidiary bank, Bank of America N.T. & S.A., San Francisco, California ("Bank"). Bank, with domestic deposits of $51.9 billion,[2] is the largest commercial bank in the United States. BAC also operates numerous nonbanking subsidiaries located throughout the United States and abroad, including subsidiaries engaged in consumer and commercial lending, mortgage banking, leasing, data processing, investment advisory services, and certain credit-related insurance underwriting and insurance agency activities in California.

Schwab is a retail discount securities brokerage firm headquartered in San Francisco, California. Schwab operates 51 offices in 26 states and the District of Columbia, and has recently opened an additional office in Hong Kong. Schwab is a member of, and maintains seats on, various national and regional securities exchanges, including the New York Stock Exchange, the Chicago Board Options Exchange, and the Pacific Stock Exchange, and is registered with the Securities and Exchange Commission pursuant to section 15 of the Securities Exchange Act of 1934. Schwab buys and sells securities solely as agent, on the order and for the account of customers. Schwab does not purchase or sell securities for its own account except to an insignificant extent, does not engage in dealing or underwriting, and gives no investment advice. Schwab characterizes itself as a "discount" broker because its commissions are significantly lower than those charged by full-time brokers. In addition to brokerage services, full-line brokers offer investment advice. A Schwab customer is not assigned a personal representative but deals with any available representative, who in many cases enters the customer's order in an automated execution system, which can execute the order in as short a time as thirty seconds.

1 Asset data are as of September 30, 1982.

2 Deposit data are as of December 31, 1981.

Schwab also extends credit for the purchase and carrying of securities and provides securities custodial services and various other services related to maintaining customer accounts, such as individual retirement accounts, a "sweep" arrangement with an unaffiliated money market mutual fund, payment of interest on net free balances awaiting investment, and third party payment services.

Schwab's Activities Are Closely Related to Banking

Section 4(c)(8) of the BHC Act permits a bank holding company to engage, directly or through a subsidiary, in activities that the Board, after due notice and opportunity for a hearing, has determined by order or regulation to be "so closely related to banking . . . as to be a proper incident thereto." The statutory standard requires that two separate tests be met for an activity to be permissible for a bank holding company. First, the Board must determine that the activity is, as a general matter, "closely related to banking." Second, the Board must find in a particular case that the performance of the activity by the applicant bank holding company may reasonably be expected to produce public benefits that outweigh possible adverse effects.

Based on guidelines established in *National Courier Association* v. *Board of Governors*,[3] a particular activity may be found to meet the "closely related to banking" test if it is demonstrated that (1) banks generally have in fact provided the proposed activity; (2) banks generally provide services that are operationally or functionally so similar to the proposed activity so as to equip them particularly well to provide the proposed activity; or (3) that banks generally provide services that are so integrally related to the proposed activity as to require their provision in a specialized form. However, the *National Courier* guidelines are not the exclusive basis for finding a close relationship between a proposed activity and banking.[4]

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3 516 F.2d 1229, 1237 (D.C. Cir. 1975).

4 *Id.*

A. *Retail Securities Brokerage*

The undisputed facts of record demonstrate that many banks currently offer certain types of securities brokerage services. Many banks provide informal brokerage services, in which, as an accommodation to their customers, banks transmit customer orders to buy or sell securities selected by their customers to brokers for execution. In addition, banks, through the trading desks of their trust departments, routinely buy and sell securities as agent for trusts and other accounts managed by banks.[5]

As the SIA points out, Schwab's activities differ somewhat from the brokerage functions usually performed by banks: Schwab executes orders for the purchase or sale of securities directly, without the assistance of an intervening broker; and executes directly on the exchange orders involving securities listed on such exchanges. The Board finds, however, that Schwab's brokerage services are operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well equipped to provide such services.[6]

The record shows that, as part of their current services, banks often execute orders involving securities not listed on an exchange by dealing directly with dealers making a market in the particular security or with other third parties. In performing these services, banks exercise the same type of discretion and judgment with respect to the best method of execution that brokers do with respect to similar types of orders. Moreover, many banks use a number of brokers to execute orders placed

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5 Banks also administer employee stock purchase, dividend reinvestment, and automatic investment service plans, which involve the periodic purchase of a particular security or securities from a fixed list of securities, on behalf of a customer.

6 The Board has found that the execution of unsolicited orders to buy or sell securities primarily of Israeli corporations solely as agent of the customer by a company that is not a member of a securities exchange is closely related to banking. *JCT Trust Company, Ltd.*, 67 Federal Reserve Bulletin 635 (1981).

with the bank by its customers or trust department. The record shows that in selecting a particular broker to execute a given order (especially in the case of orders for a block of securities), these banks make the decision themselves as to the best method of execution, leaving to the broker only the technical execution of the transaction. The Securities and Exchange Commission's 1977 report on bank securities activities found that bank trust department trading desks, at least at the largest banks, perform the same functions, utilize the same execution techniques, employ personnel with the same general training and expertise, and use the same facilities, *e.g.*, the consolidated tape, Quotron, AutEx, and other market information services, that brokers do.

In addition, national banks are expressly authorized by statute to purchase and sell securities without recourse, solely upon the order, and for the account of, customers. 12 U.S.C. § 24 Seventh. This authority supports the conclusion that Schwab's brokerage activities, which are within the plain meaning of the language of this authorization, are closely related to banking.[7]

Although the record indicates that in 1977 generally only the largest banks employed sophisticated securities trading procedures and resources, the record also shows that the technological changes in the securities markets and other developments have forced bank securities traders in large banks to develop and expand their skills and that this trend is expected to continue.[8] The Board finds that the use of sophisticated tech-

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7 The SIA asserts that this statutory authorization is limited to providing accommodation brokerage services to existing customers of the bank. Even if this assertion were correct, the fact that an activity is not permitted to a bank does not preclude a finding that the activity is *closely related* to banking and thus permissible for a bank holding company. *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 64 (1981).

8 Schwab also maintains customers' accounts and clears and settles executed transactions. Banks perform these functions in connection with the buy or sell orders banks effect for trust departments and as an accommodation to their customers. In addition, as a retail broker,

niques, resources and personnel to execute orders for the purchase or sale of securities for the account of customers is sufficiently widespread in the banking industry to justify a finding that banks generally provide securities execution services that equip them to offer the type of retail brokerage services provided by Schwab. Moreover, the Board finds that execution "in the crowd" on an exchange[9] is a largely ministerial function that involves no greater expertise or resources than the execution of orders directly with third party market makers, which banks generally now perform.[10]

The conclusion that Schwab's brokerage activities are closely related to banking is also consistent with the purposes of the BHC Act, which mandates the separation of banking from commerce in order to guard against the potential concentration of financial resources, conflicts of interest in the control of credit, and risks to insured depository institutions that are likely to result from the control by banking organizations of commercial enterprises. The laws restricting bank involvement in the investment banking business generally, while expressly recognizing that banks have been historically involved in some

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Schwab deals directly with the public to a far greater extent than the typical bank that offers securities brokerage services. However, the Board concludes that the degree of contact with the public does not substantially alter the type of expertise and judgment necessary to perform execution services, which in the case of both Schwab and banks generally is substantially the same.

9 Exchange members that are specialists in particular securities may exercise significant discretion and judgment with respect to trading in those securities. Specialists, however, trade for their own account. Schwab does not buy or sell securities for its own account and is not, therefore, a specialist on any exchange.

10 The fact that in many cases banks rely on brokers to execute customer orders placed with the bank does not preclude a finding that banks are well equipped to execute these orders directly, since the record shows that to a significant extent banks do effect buy and sell orders directly without the intervention of a broker or employ the broker merely to carry out the decision as to the method of execution made by the bank.

types of securities activities, are also designed to avoid conflicts of interest and risks to the safety of depository institutions.

B. *Margin Lending*

Schwab also engages in the extension of margin credit to Schwab's brokerage customers for the purchase and carrying of securities. Banks generally and traditionally have extended credit to their customers for the purpose of buying and carrying securities. At the end of 1981, banks had outstanding approximately $5 billion in loans to borrowers other than securities firms or financial institutions for the purpose of purchasing or carrying securities. In addition, the extension of credit secured by stock and other collateral has long been an important bank activity. The Board's margin credit regulations apply both to brokers such as Schwab (Regulation T) and to banks (Regulation U).[11] While Regulations T and U impose somewhat different requirements, the underlying margin credit activity engaged in by both banks and brokers is functionally the same. The Board therefore concludes that Schwab's margin lending activity is closely related to banking.

C. *Maintenance of Customer Securities Accounts*

In connection with carrying accounts of its securities brokerage customers, Schwab offers various services to its brokerage customers. These services include: (1) Individual Retirement Accounts, for which an unaffiliated savings and loan association serves as trustee; (2) a "sweep" arrangement, pursuant to which idle customer balances exceeding a predetermined minimum are automatically invested in an unaffiliated money market mutual fund; (3) the payment of interest on net free balances awaiting investment; and (4) the "Schwab-One Account," which combines the payment of interest on free credit balances with customer access to such balances through a debit card and checking account offered under an arrangement with

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11 12 C.F.R. Parts 220, 221.

an unaffiliated commercial bank. These services are increasingly being offered by other brokerage firms. The Board finds that each of these services is identical, or functionally and operationally equivalent to, services generally offered by banks to customers directly or through banks' trust departments. Accordingly, the Board finds, on the facts of this case, that BAC's provision through Schwab of IRA accounts, a money market sweep, and the "Schwab One Account" is closely related to banking as well as an incidental activity in connection with Schwab's securities brokerage and margin lending activities.

D. *Custodial Services*

Schwab also provides various types of securities custodial services, involving the safekeeping of customers' securities, accounting for dividends or interest received on such securities, and other ancillary services. Banks generally offer securities custodial services in connection with their trust department and other securities transaction services. In addition, in extending margin credit, a lender is required to maintain custody of the securities pledged to the lender as collateral to secure the loan. Accordingly, the Board finds that the provision of securities custodial services is closely related to banking and is a necessary incident to permissible margin lending activities.

"Proper Incident"—Net Public Benefits

With respect to the "proper incident" requirement, section 4(c)(8) of the Act requires the Board to consider whether the performance of the proposed nonbanking activity by an affiliate of a bank holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." The Board finds that consummation of this proposal can reasonably be expected to result in public benefits outweighing possible adverse effects.

A. *Public Benefits Are Likely to Result from the Proposal*

1. *Increased Competition*

The record shows that the proposed acquisition is likely to make Schwab a more effective competitor in the retail brokerage market. It is likely that the proposal will strengthen Schwab as a competitor by affording Schwab greater acceptability by the public. The record indicates that discount brokers in general are hampered competitively, at least to some extent, because of a lack of public awareness and acceptance of their services due, in large part, to the relatively recent emergence of discount brokers and their lack of extensive office networks. Schwab's affiliation with BAC, a large, internationally recognized and diversified banking and financial services company with substantial resources, can reasonably be expected to result in enhanced public recognition and confidence in Schwab in particular, and discount brokers in general.

As a relatively new and small company, Schwab needs capital in order to expand its office network and facilities. It is undisputed that, because of its affiliation with BAC, Schwab expects to be able to obtain funds at a lower cost and more efficiently than at present.[12] The proposal is also likely to provide Schwab with access to BAC's managerial and technological resources, which, in view of BAC's size and expertise, are likely to assist Schwab in becoming a more effective competitor.[13]

Strengthening Schwab as a competitor is likely to have a procompetitive impact on price competition in the retail bro-

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12 The SIA's claim that Schwab currently has no difficulty in raising capital is immaterial (even if true), since an improvement in the cost and methods of raising funds is likely to produce an increase in Schwab's ability to compete for brokerage services. As explained below, the anticipated improvement in funding would not result in any unfair competitive advantage, because, among other things, BAC, not Bank, would provide funds to Schwab.

13 BAC has an extensive network of offices in this country and in many other countries and plans to assist Schwab in opening new offices.

kerage industry.[14] Since Schwab, like other discount brokers, competes primarily and aggressively on the basis of price, the strengthening of Schwab may induce full-line brokers to compete more vigorously for brokerage business on the basis of price. It is uncontested that the lower commission rates charged by discount brokers are taken into account by full-line brokers. The Recommended Decision forecast that this acquisition might produce a major change in the price structure of the brokerage industry by causing full-line brokers to "unbundle" their services. However, the evidence in the record is not substantial either in support of or against such a change. In any event, the acquisition is likely to have some procompetitive effect.

With respect to the likelihood of increased competition in the development of technology and in the provision of new combinations of financial services, the record indicates that Schwab has developed one of the most sophisticated automated order execution systems in the industry, which is important to Schwab's competitive efforts. Since this type of automated technology is rapidly developing and requires large financial resources to support such development, Schwab's access to BAC's funding support and technical resources can aid Schwab in continuing to offer efficient automated systems, which is likely to have a procompetitive effect throughout the industry.

2. *Increased Convenience and Efficiencies*

With respect to projected increases in convenience and efficiencies, the record shows that BAC will assist Schwab in adding new offices, some of which may be at locations where Bank has branches or where BAC's other nonbank subsidiaries have offices. While most of Schwab's brokerage business is done by telephone or mail, there is evidence in the record that some office locations are necessary to provide effective service.

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14 The SIA claims that there already is active price competition among retail brokerage firms. However, the fact that a market already is competitive does not preclude any further increase in competition.

Customers can make payments and deposit securities at Schwab offices without the inconvenience or cost of, or risk of nondelivery by, mail.

Moreover, the acquisition will permit Schwab and BAC to share their capital, managerial, technological, and marketing resources. In addition, by facilitating joint purchases or securities brokerage and other financial services, the acquisition can be expected to result in lower consumer search costs and greater efficiency in the purchase of such services.

In summary, the Board finds that this acquisition can reasonably be expected to result in some significant public benefits in the form of intensified competition, increased efficiency, and greater consumer convenience in the provision of retail securities brokerage services to the public.

B. *Lack of Significant Adverse Effects*

Having considered the facts of record and the allegations of all of the parties, the Board finds that the proposal is not likely to result in any significant adverse effects.

1. *Unlikelihood of Undue Concentration of Resources or Decreased Competition*

Assessment of the potential competitive impact of this proposal begins with a definition of the relevant product and geographic markets. The relevant product market includes all products that are reasonably interchangeable in practical function and use.[15] It is not disputed that retail securities brokerage constitutes a relevant product market. The SIA contends that discount securities brokerage is a relevant product submarket.[16] Based on the facts of record, the Board concludes

15 E.g., *United States* v. *E.I. duPont de Nemours & Co.*, 351 U.S. 377, 395 (1956).

16 The existence of a product submarket is determined by examining such practical indicia as industry or public recognition as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325 (1962).

that discount brokerage is not a sufficiently unique product to be considered a separate submarket. The record shows that some discount brokers offer investment advice in addition to the execution of buy and sell orders, while some full-line brokers offer discount brokerage services to large, active retail customers. According to the record, discount and full-line brokers are viewed by the public as reasonable substitutes, since many of Schwab's new customers are gained from full-line brokers, while Schwab has lost customers to full-line brokers.

The relevant geographic market is comprised of the market area in which the seller operates and to which the purchaser can practicably turn for supplies.[17] With 51 offices in 26 states and the District of Columbia, Schwab operates nationwide. Schwab is licensed to do business in all fifty states, has a uniform nationwide pricing policy, and advertises chiefly in nationwide financial publications. Customers can obtain access to Schwab's service from any place in the country by calling a toll-free telephone number. Based on this and the other evidence of record, the Board finds that the relevant geographic market for purposes of this proposal is the United States.[18]

The Board finds that this acquisition will not result in any significant reduction of competition or any increase in concentration of resources to an undue level in any relevant market. With respect to undue concentration of resources, while BAC has substantial assets ($112.9 billion in 1981), Schwab is not of significant asset size ($104 million). BAC's acquisition of

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17 *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 359 (1963).

18 The SIA claims that the State of California is the relevant geographic market on the theory that that area represents the area of competitive overlap between BAC and Schwab. This contention ignores the fact that Schwab and BAC each compete in different product markets. For similar reasons, the SIA's contentions regarding the inclusion of nonbank financial institutions in the banking product market are immaterial, since Schwab, the firm to be acquired, does not engage in banking activities.

Schwab (an increase of less than one per cent in BAC's assets) would not result in any unwarranted increase in the concentration of resources controlled by BAC.

The record indicates that Schwab's acquisition by BAC would not eliminate any significant existing competition in the nationwide retail brokerage market.[19] Schwab's share of the retail brokerage market, expressed in terms of a percentage of total commissions in that market, is less than one per cent. Bank's brokerage activities, primarily an accommodation for existing customers and employees, do not represent a significant market share.[20] While BAC may be viewed as a potential entrant into the retail securities brokerage market, that market is unconcentrated and characterized by low barriers to entry and numerous potential entrants.

The SIA notes that BAC anticipates an increase in Bank's deposits after the acquisition as a result of cross-selling Bank's services to Schwab's customers. While significant concentration exists in some local California banking markets and BAC's market share in those markets is significant, this acquisition will not directly cause any increase in Bank's deposits in any market. Such an increase, if it occurs, would result from success in cross-selling by BAC. In any event, the projected increase in Bank's deposits is of *de minimis* proportions.[21]

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19 Both Bank and Schwab engage in extending margin credit for the purchasing and carrying of securities. To the extent margin lending is a separate product, the proposal would not eliminate any significant competition. Neither Bank's nor Schwab's outstanding margin loans are substantial.

20 There is no substantial record evidence that the Board's conclusion concerning lack of elimination of potential competition would be altered even if discount brokerage were viewed as a product submarket. The record does not indicate that such a submarket is highly concentrated or that the number of potential entrants is low. Indeed, recent developments suggest that many banks must now be viewed as likely entrants into any such discount brokerage submarket.

21 It is not likely that BAC would gain significant competitive advantage from the projected growth in Bank's deposits since other large California banks, *i.e.*, Security Pacific National Bank and Crocker

The SIA contends that BAC's acquisition will eliminate competition in the brokerage product market by forcing other discount brokers either to become affiliated with a banking organization or be driven from the market. There is no evidentiary support for this allegation. However, even if the SIA's hypothesis is correct, it does not necessarily lead to the conclusion that competition will be diminished as a result. Indeed, such affiliations are likely to increase the vigor of competition. Moreover, the SIA does not contend that the acquisition will preclude any further entry into the retail brokerage market.

2. *Unlikelihood of Unfair Competitive Practices*

The SIA contends that, as a result of the acquisition, Schwab would have an unfair advantage over other brokers in the rates Schwab would pay for its funding. BAC plans to provide funding to Schwab by lending to Schwab the proceeds of funds raised directly by BAC. The SIA asserts that, because of explicit and implicit guarantees given by the federal government to the creditors of Bank (BAC's major asset),[22] BAC is able to raise funds at lower rates than brokerage firms that are not affiliated with a bank. According to the SIA, this alleged funding advantage is unfair because it rests on federal guarantees unavailable to brokerage firms not affiliated with banking organizations.[23] The SIA also argues that after the acquisition Schwab could obtain funds from BAC at rates lower than it currently pays and that this reduction in funding costs is not economically justified. The Board finds no significant adverse

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National Bank, have recently entered the retail brokerage field, and other banking organizations are also likely to enter.

22 Creditors of a bank holding company are not protected by federal deposit insurance. The SIA contends, however, that the government would come to the aid of any large bank in difficulty to maintain the stability of the financial system and that such assistance would benefit the parent holding company.

23 Brokerage firms benefit from a federal guaranty, *i.e.*, the Securities Investor Protection Corporation.

effects are likely to result from the proposed method of funding Schwab.

The record does not demonstrate that BAC's costs of funds are significantly lower than those of other corporations of similar resources. For example, the rates paid by BAC on its commercial paper during May through July 1982 were generally the same or higher than rates on commercial paper paid by corporations of similar size and credit ratings. Moreover, any cost advantage in raising funds enjoyed by BAC may be due to economic factors such as BAC's size, capital, and earnings, rather than to any guarantees applying to Bank alleged by SIA.[24] In any event, the Board finds that any advantage Schwab might obtain as the result of its borrowing from BAC is not unfair competition for purposes of section 4(c)(8). The legislative history of that section indicates that the term "unfair competition" was intended to refer to unfair or unethical business conduct (as defined by common law or under state or federal law), not disparities or advantages based on the structure and operations of the banking industry.[25] While the original 1956 BHC Act severely restricted borrowing by a bank holding company (or its nonbank subsidiaries) from its subsidiary bank,[26] Congress expressly declined to prohibit "downstream" financing, *i.e.*, borrowing by any subsidiary in the system from the parent. Congress found that downstream

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24 BAC states that funds for Schwab would be provided by the parent holding company, not by Bank. Thus, any cost advantage Bank might enjoy because its deposit liabilities are federally insured is immaterial. In any event, it should be emphasized that the extent to which funds from Bank may be transferred to Schwab is strictly limited by section 23A of the Federal Reserve Act. 12 U.S.C. § 371c.

25 H.R. Rep. No. 1747, 91st Cong., 2d Sess. 18-19 (1970). The legislative history identified such practices as intimidation of customers and commercial espionage. *Id.*

26 70 Stat. 133, 137. These limitations were repealed in 1966 on the grounds that they were unnecessary in light of the similar, more flexible restrictions in section 23A of the Federal Reserve Act. 80 Stat. 236, 240; S. Rep. No. 1179, 89th Cong., 2d Sess. 10-11 (1966).

financing is a beneficial advantage of the bank holding company structure and permits the parent holding company to draw on its own capital and funds to strengthen the financial condition of its subsidiaries.[27] Recognizing this advantage, Congress authorized bank holding companies to acquire certain types of *nonbank* subsidiaries, which would compete against firms in the same line of commerce.

Moreover, the Board finds no basis in the SIA's claim that Schwab's ability to obtain low cost funding from BAC is economically unjustified. The Administrative Law Judge found, and the SIA does not contest, that the rate of interest BAC charges its subsidiaries on loans to such subsidiaries reasonably approximates BAC's own cost of funds. Moreover, the fact that the rates at which Schwab would be able to obtain funding might be lower than the rates at which other brokers pay does not *per se* demonstrate that the rates BAC charges Schwab are unfair or unjustified, since other economic factors not applicable to Schwab or BAC (*e.g.*, lower capital or earnings or lack of complete credit information) might justify higher rates paid by other brokers.[28]

The SIA also asserts that BAC intends to cross-sell banking services to Schwab customers, and thus has an incentive to subsidize Schwab's brokerage business. Cross-subsidization is an unfair competitive practice that occurs when the profits of one company are used to enable an affiliated company to offer its services at prices below its costs.[29] Cross-subsidization is successful, and therefore a likely practice, only where a company offering below-cost pricing has sufficient market domi-

27 S. Rep. No. 1095, 84th Cong., 1st Sess. 15 (1955).

28 The Board does not accept the SIA's contention that BAC will lend funds to Schwab without regard to the risk involved. The record indicates that BAC does account for risk in determining the amount of funds to advance to a nonbank subsidiary and in determining whether an appropriate return will be earned on such advances.

29 *E.g.*, *Citicorp (Citishare)*, 68 Federal Reserve Bulletin 505, 512 (1982).

nance to be able to eliminate competitors by sustained below-cost pricing and thereafter to raise prices to recover the losses incurred through offering services below cost. It is clear from the record that Schwab does not have such a dominant position in the retail brokerage market and that the industry has very low barriers to entry. There is no evidence that BAC plans to offer brokerage services through Schwab at below Schwab's costs. The evidence shows that BAC expects Schwab to provide a positive return on equity.[30] The record evidence showing that BAC intends to cross-sell banking services to Schwab brokerage customers does not in itself demonstrate that BAC will cause Schwab to offer services at below cost.

Bank serves as a dealer in municipal securities. After the announcement of this proposal, BAC and Schwab entered into an arrangement under which Schwab provides its customers with information on municipal securities Bank holds in its inventory. The SIA contends that, since bank dealers in municipal securities enjoy more favorable tax treatment than nonbank dealers,[31] the arrangement between Schwab and Bank would permit Bank to exploit this allegedly "unfair" competitive advantage. However, the Board finds that any such competitive advantage results from the application of the federal tax laws, which affect all participants in the municipal securi-

30 The SIA contends that BAC will have an incentive to subsidize Schwab's services because SIA expects that some Schwab customers will bring business to Bank and that Bank's earnings from this increased business will be greater than the losses caused by offering brokerage services at below cost. This contention, in the Board's view, is not based on any evidence in the record. The Board also notes that competition by financial institutions for deposits is strong, making it unlikely that Bank would be able to attain profit levels on deposits by customers of Schwab that would justify cross-subsidization. Moreover, in this connection, the Board notes that federal limitations on interest rates payable on deposits are being rapidly eliminated, resulting in increases in the cost of deposits.

31 The interest paid by nonbank dealers on funds borrowed to finance their inventory of municipal securities is not deductible for federal income tax purposes. 26 U.S.C. § 265(2). Bank dealers are exempt from this provision.

ties markets, and does not represent the type of adverse effect about which the BHC Act was concerned.

The Board further finds that the risk of voluntary tying of bank credit to use of Schwab's brokerage services is not substantial, given existing legal,[32] regulatory and internal BAC safeguards, and the record facts. Voluntary tying results when a customer believes that he or she stands a better chance of obtaining a scarce product by purchasing another product or service from the same seller. Where both products are in ample supply, voluntary tie-ins are not likely. These implicitly coerced joint sales are different from voluntary joint sales which, as the Administrative Law Judge found, can result in benefits to the customer by reducing search costs for the consumer and increasing efficiencies inherent in joint production and sale.

As the Board has previously found, the likelihood of voluntary tying depends on market structure and on the offering of a product that is relatively scarce.[33] The possibility of such tying is significantly reduced in competitive markets where there is a large number of alternative sources of the product involved (*e.g.*, credit). The Board finds that there are many alternative sources of credit (both bank and nonbank) available to the customers (mostly individuals) that are likely to use a discount broker like Schwab.

The SIA claims that because BAC intends to promote Schwab's services and because Bank's pricing of loans or other services, as a matter of policy, takes account of a customer's relationship with a nonbank subsidiary in the BAC system, there is the likelihood of implicitly coerced joint sales. The record shows that employees of Bank are expressly advised not

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32 Explicitly coerced joint sales are expressly prohibited by section 106 of the BHC Act Amendments of 1970, 12 U.S.C. §§ 1972-78, and are not an issue in this application.

33 *E.g.*, *Citicorp (Person-to-Person Financial Center)*, 67 Federal Reserve Bulletin 443, 446 (1981). There is no evidence that brokerage services are such a scarce service that brokerage customers of Schwab will feel implicitly coerced into seeking deposit or credit services of Bank in order to continue to obtain brokerage services from Schwab.

to create even the impression that a customer might enhance the likelihood of obtaining a desired service by purchasing other products or services from Bank or its affiliates. Moreover, the record shows that customers of Bank that would be likely to use a discount broker are also likely to be (as are Schwab's current customers) relatively knowledgeable about financial matters. Such customers are less likely to be implicitly coerced into using brokerage services that are not independently desired. The Board does not believe the evidence suggests the likelihood of significant coerced joint sales.

3. *Unlikelihood of Other Adverse Effects*

The Board finds no persuasive evidence that BAC's acquisition of Schwab would result in significant conflicts of interest. The possibility that Bank might make unsound loans to Schwab customers to maximize Schwab's profits is not substantial and is neither based on evidence nor reasonable. Moreover, it would not be rational for Bank to place its own funds at risk in an unsound loan merely to increase brokerage commissions earned by Schwab. The Board finds no realistic basis for the SIA's contention that Schwab might "dump" worthless municipal securities on its customers as a result of its arrangement with Bank's municipal securities dealer operations. Under this arrangement Schwab identifies for its customers municipal securities held in Bank's inventory and does not give investment advice concerning the purchase or sale of the securities. There does not appear to be any substantive basis for any conflicts of interest arising from this procedure. Nor is there any credible evidence that Bank would breach its fiduciary duty by placing orders with Schwab for the purchase or sale of securities by Bank's trust department or customers where Schwab would not effect the best execution of the order.[34] There is no record evidence suggesting that Bank

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34 Bank's trust department is subject to a judicially enforceable duty to obtain best execution of orders under applicable statutes (15 U.S.C. § 78bb(e)(2)) and related regulations of its federal supervisor. 12 C.F.R. § 9.5, 47 Fed. Reg. 27831 (1982).

would use Schwab's services in situations that would result in a breach of fiduciary duty.

The earnings of discount brokers are heavily dependent on the volume of trading in securities and have fluctuated to a significant degree. However, the SIA's claim that Schwab is a high risk enterprise and that BAC might be compelled to make unsound loans to shore up Schwab is not supported by the record. Despite fluctuations in earnings, discount brokers in general, and Schwab in particular, have been profitable. Schwab's income has grown significantly in recent years. Schwab is not a speculative enterprise and the financial risks to BAC as a result of this proposal do not appear to be any greater than the risks involved in other permissible nonbank activities. The Board finds that it is unlikely that significant financial risks to BAC or Bank would result from the proposal.

The Board finds no basis for the SIA's contention that, because BAC intends to advertise its affiliation with Schwab, the proposed acquisition would result in public confusion. There is no evidence that BAC would misrepresent the nature of Schwab's affiliation with BAC or Bank, and BAC should assure that fully adequate disclosure of the status of Schwab obligations is made available to all customers.

The SIA further contends, without any evidentiary record for its claim, that Schwab solicits customers to place funds in Schwab's cash management account solely to earn interest and not for purchasing securities, that such funds might not be protected by Securities Investor Protection Corporation insurance (a protection that Schwab advertises), and that such an account constitutes the unlawful taking of deposits. The Board finds no basis for this allegation on the facts of this case. Guidelines issued by the Securities and Exchange Commission restrict registered brokers, such as Schwab, from soliciting funds solely to earn interest.[35] The rules of the New York Stock Exchange prohibit a member (such as Schwab) from paying interest on any free credit balance created for the purpose of

35 3 Fed. Sec. L. Rep. (CCH) ¶ 25,134B.

receiving interest.[36] There is no evidence that Schwab will not comply with these limitations or that Schwab's advertising of SIPC insurance will be materially misleading.

In the exercise of its responsibility under the BHC Act, the Board has carefully considered whether BAC's financial and managerial resources are adequate to effect the proposed acquisition. In its evaluation of BAC's financial resources, the Board has reviewed all the relevant data concerning BAC's financial condition. Based upon this review, the Board concludes that the proposed acquisition would not represent a significant additional burden on BAC's financial resources. The Board notes the improvement in BAC's capital over the past year and expects that BAC will continue its efforts to improve its capital position. On balance, the Board concludes that BAC has both financial and managerial resources that are consistent with approval.

In sum, the Board finds that this acquisition may reasonably be expected to result in public benefits that outweigh possible adverse effects. Accordingly, since this acquisition satisfies both the "closely related" and the net public benefits tests of section 4(c)(8), the Board finds no basis for the SIA's contention that BAC must be required to enter the retail securities brokerage industry *de novo*.[37]

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36 *Id.*

37 The decisions cited by the SIA where the Board has denied the acquisition of a going concern by a bank holding company with the resources for *de novo* entry are inapposite. In those cases, the Board expressly found that acquisition of the going concern would eliminate substantial potential competition. *BTNB Corp.*, 58 Federal Reserve Bulletin 70, 71 (1972); *Marine Bancorporation*, 58 Federal Reserve Bulletin 504, 505 (1972); *Crocker National Corp.*, 58 Federal Reserve Bulletin 419, 420 (1972). Section 4(c)(8) does not require *de novo* entry by a bank holding company if, as here, the company's acquisition of a going concern will not substantially lessen competition and is likely to produce benefits that outweigh possible adverse effects.

The Acquisition Is Consistent with the Glass-Steagall Act

The SIA and various other commenters contend that the acquisition of a securities brokerage firm by a bank holding company is prohibited by provisions of the Glass-Steagall Act, the popular term for provisions of the Banking Act of 1933, that insulate commercial banking from certain aspects of the securities business. Section 20 of the Glass-Steagall Act (12 U.S.C. § 377) prohibits the affiliation of any bank that is a member of the Federal Reserve System with any corporation or similar organization that is "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities.[38] For the reasons stated and upon the findings made in this Order, the Board concludes that Schwab is not engaged principally in any of the activities prohibited to member bank affiliates by the Glass-Steagall Act and accordingly concludes that this acquisition is consistent with the letter and spirit of that Act.

As a result of the consummation of this proposal, Bank, a member bank, would become affiliated with Schwab for purposes of section 20.[39] The SIA alleges that Schwab is engaged principally in the "public sale" of securities within the proscription of section 20 by virtue of its retail brokerage activities.[40] The Board finds, however, that the business of purchasing or selling securities upon the unsolicited order of, and as agent for, a particular customer does not constitute the

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38 Section 16 of the Glass-Steagall Act, 12 U.S.C. § 24 Seventh, provides that a national bank's dealing in securities and stock is limited to "purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers" and not for the bank's own account [illegible] that a national bank "shall not underwrite any issue of [illegible] stock." Section 21, U.S.C. § 378, prohibits any organi[illegible] deposits to engage at the same time "in the business [illegible] writing, selling, or distributing" securities.

39 12 U.S.C. § 221a(b)(2).

40 It is undisputed that Schwab's brokerage activities do not constitute the "issue, flotation, underwriting . . . or distribution" of securities.

"public sale" of securities for purposes of section 20. It is significant that, in describing proscribed activities of bank affiliates, section 20 does not mention "brokerage" activities, the generic term commonly associated with the business of buying and selling securities as agent for a customer.[41] In addition, in executing a customer's order to buy or sell securities, a broker does not make a public offer or hold itself out to the public as a seller or buyer for its own account but only acts as agent to assist the seller or buyer.[42] Furthermore, the terms "issue," "flotation," "underwriting," and "distribution" (used in section 20 in conjunction with "public sale") generally refer to the process by which new issues or large blocks or securities are distributed to the public, not to brokerage functions, which are primarily concerned with the transfer of securities at the request of a particular customer.[43] The term "public sale" used in association with this series of terms should be given a meaning similar to those terms since, under the rules of statutory construction, words grouped in a list should be given a related meaning.[44]

The view that "public sale" was not intended to apply to purchasing or selling securities as agent for a customer is further supported by the fact that the Board has consistently interpreted section 32 of the Glass-Steagall Act (12 U.S.C. § 78) as not applying to any brokerage activities. Section 32

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41 2 L. Loss, *Securities Regulation* 1215 (2d ed. 1961). A securities *dealer* sells securities it has purchased for its own account elsewhere or purchases securities for its own account with a view toward selling them elsewhere. *Id.* A dealer ordinarily maintains an inventory of particular issues of securities and holds itself out to the public as being willing to purchase or sell such securities for its own account. A dealer is thus unlike a broker, which acts for the account of a customer.

42 *Cf.* Securities and Exchange Commission, Final Report on Bank Securities Activities 121-22, 167 (1977).

43 1 L. Loss, *supra* at 159-72.

44 *E.g.*, *Third National Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977).

prohibits managerial interlocks between a member bank and a firm primarily engaged in the same securities activities described in section 20. Beginning in 1936, the Board's Regulation R, which implements the provisions of section 32, has consistently provided that "[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32."[45] Since section 20 and section 32 are part of the same statute and were enacted for the same purpose, the meaning of "public sale" as used in section 20 should be interpreted consistently with the same term in section 32.[46]

The SIA and other commenters contend that Schwab's retail brokerage activities are prohibited to banks under section 16 of the Glass-Steagall Act and thus should not be permitted to affiliates of banks. However, as the Supreme Court has made clear, section 20 determines the permissible securities activities of an affiliate of a bank and the fact that a bank might be precluded from engaging in a particular securities activity does not necessarily mean that a bank holding company is precluded from performing such service.[47] Moreover, section 16 *authorizes* national banks to engage in retail brokerage, *i.e.*, to

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45 22 Federal Reserve Bulletin 51 (1936), *codified at* 12 C.F.R. § 218.1 n.1.

46 The Board's view that brokerage activities do not constitute the public sale of securities was implicitly upheld by the Supreme Court in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947). In *Agnew*, the Court affirmed a Board order finding that a particular securities firm with significant income from both underwriting activities and brokerage activities was "primarily" engaged in underwriting securities and thus covered by section 32. 329 U.S. at 445-46. The Supreme Court affirmed the Board's finding that the firm was primarily engaged in underwriting even though the amount of underwriting done by the firm did not exceed 50 per cent of its business. *Id.* at 447-49. The Court left undisturbed the Board's implicit finding that the brokerage business was not part of the business described in section 32.

47 *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 63-64 (1981).

engage in "purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers." 12 U.S.C. § 24 Seventh.

The SIA concedes that section 16 expressly authorizes some securities brokerage activities for banks, but contends, based on early interpretations of section 16 by the Comptroller of the Currency, that national banks are limited to executing orders without profit and only as an accommodation to existing customers, and that Schwab's services, not tied to the customers of any bank, clearly exceed these limitations.[48] However, beginning in 1957, the Comptroller has gradually departed from these early interpretations on the grounds that they are not supported by the express language of the statute, reflected an overcautious approach to bank regulation in the aftermath of the Great Depression, and are erroneous. Indeed, the Comptroller has recently authorized a national bank to establish a subsidiary to engage in discount brokerage services substantially the same as those provided by Schwab[49] and has advised the Board, in comments on BAC's proposal, that a national bank's purchase and sale of securities as agent is permissible under the Glass-Steagall Act.[50] In any event, inde-

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48 *See, e.g.*, 20 Federal Reserve Bulletin 609 (1934).

49 Comptroller of the Currency, Decision on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc. (August 26, 1982). The SIA is seeking judicial review of this decision. Among other things, the SIA has alleged that the establishment by a national bank of brokerage offices at locations where the bank is not permitted to branch violates the National Bank Act. The Board finds that there would be no violation of the federal branching laws in this application under the BHC Act, since Schwab is a separate corporation, has its own capital and officers and directors, and would not be operated in a unitary fashion with Bank, but as a nonbank subsidiary of a bank holding company. *See Grandview Bank & Trust Co.* v. *Board of Governors*, 550 F.2d 415 (8th Cir.), *cert. denied*, 434 U.S. 821 (1977).

50 The SIA argues that Schwab's activities do not meet the "without recourse" requirements of section 16, since in many cases Schwab executes transactions directly without the assistance of an intervening

pendent of the validity of the Comptroller's constructions of section 16, the Board finds that Schwab's brokerage functions do not constitute the "public sale" of securities (or any other proscribed activity) within the meaning of section 20 of the Glass-Steagall Act, the applicable statutory provision.[51]

This conclusion is consistent with the purposes of the Glass-Steagall Act. During congressional consideration of the Glass-Steagall legislation, the scope of permissible bank brokerage activity was not discussed in detail.[52] However, since the types of bank securities activities considered harmful and contrary to public policy were exhaustively catalogued in the legislative history and brokerage activities received no serious attention, it is unlikely that Congress viewed such activities as the target of the Act's prohibitions.[53] Indeed, the particular type of securi-

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broker against whom Schwab's customers might otherwise have recourse for any alleged fraud or negligence. However, in the Board's view, the ordinary commercial meaning of "without recourse" indicates that section 16 prohibits a bank from assuming the liability of endorser or maker with respect to the securities bought or sold as agent of the customer. *See* G. Munn & F. Garcia, Encyclopedia of Banking & Finance 943 (7th ed. 1973; U.C.C. § 3-414(1)). There is no evidence that Schwab would assume any such liability.

51 The SIA further asserts that "public sale" in section 20 must be interpreted similarly to the terms "purchasing and selling" as used in sections 16 and 21, which, the SIA contends, clearly include brokerage functions. However, section 16 expressly permits purchasing and selling securities for the account of customers.

52 The relevant legislative history merely states that national banks would be permitted to buy and sell securities for their customers to the same extent as heretobefore. S. Rep. No. 77, 73rd Cong., 1st Sess. 16 (1933).

53 The SIA's reliance on various statements by a draftsman of the Securities Exchange Act of 1934 is without merit. These statements were made after enactment of the Glass-Steagall legislation, are not the views of a member of the legislature, and do not purport to deal with the outer limits of permissible bank brokerage activities. In addition, the Comptroller of the Currency's explanation of the 1935 amendment to section 16 (which merely clarified that the scope of permissible

ties activities engaged in by Schwab are fully consistent with the objectives of the Glass-Steagall Act. As has been widely recognized, the Glass-Steagall legislation was intended to eliminate the risk of loss or insolvency that may result when a bank purchases securities for resale to the public, makes unsound loans to bolster its marketing of particular securities, or loses public confidence when it becomes apparent that the bank has a "salesman's stake" in the success of a particular investment opportunity.[54] Further, as noted above, the Board believes that Schwab's activities pose no greater risk of failure than other nonbanking activities permitted by the Board to bank holding companies. The Board finds that these types of hazards are not present in connection with Schwab's activities, since, except on very infrequent occasions, Schwab does not purchase or sell securities as a principal, *i.e.*, with its own assets.[55] Nor does Schwab have any interest in the success or failure of any particular issue of securities, since its operations are limited to

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brokerage included execution of orders for stock as well as for debt securities) appears merely to be a statement of the Comptroller's now-rejected administrative interpretation of the 1933 legislation.

54 *E.g.*, *Board of Governors* v. *Investment Company Institute*, *supra*, 450 U.S. at 61-62; *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629-34, 635-38 (1971). The SIA's reliance on the Supreme Court's passing remark in the second *ICI* decision that the ACT was intended to divorce banks from underwriters and brokerage houses, 450 U.S. at 63, is misplaced. Brokerage activities were clearly not at issue in that case. Also, most brokerage firms also engage in dealing in securities, an activity that *is* generally impermissible under the Act. *See* 2 L. Loss, *supra* at 1215.

55 Schwab acts as a principal if it mistakenly purchases securities not authorized by the customer. Such "inadvertent principal" transactions are less than one per cent of Schwab's business and clearly not a principal activity. In addition, in infrequent cases, Schwab may purchase municipal securities in a new issue as riskless principal—with its own assets but only after a firm customer order for such securities has been received. These riskless principal transactions (also not a principal activity of Schwab) appear to be consistent with permissible brokerage activities, and, in any event, section 16 expressly authorizes banks to act as principal with respect to certain types of municipal securities.

providing a service enabling investors to purchase or sell expeditiously securities selected by the customer. Although, as the SIA points out, unsuccessful operations by an affiliate may well damage the reputation of a bank or bank holding company, the Board finds that the likelihood of harm to the reputation of BAC or Bank as a result of this proposal is minimal, since Schwab does not actively promote any particular securities and does not offer investment advice.

Schwab also offers to its customers a "sweep" arrangement, under which idle customer balances awaiting investment and exceeding a predetermined amount are routinely and automatically used to purchase shares of an unaffiliated money market mutual fund. The Board has pending before it a separate petition submitted by the SIA alleging that such "sweep" arrangements by banks constitute the impermissible underwriting of the securities of the money market mutual fund and believes that this issue is more appropriately resolved in that context. Even if it is assumed that Schwab's sweep arrangement constitutes underwriting of the money fund's securities, the record clearly shows that Schwab is not principally engaged in that activity. Thus, no violation of section 20 would arise as the result of the present application.

Proposed Restrictions on Schwab's Activities

The SIA asserts that, if the Board determines to approve the proposal, various restrictions should be imposed to address the alleged adverse effects of the acquisition by limiting Schwab's activities solely to securities brokerage, by restricting the method by which Schwab obtains funds, establishes offices, advertises its affiliation with BAC, and by prohibiting Bank from using Schwab to execute transactions for Bank's fiduciary accounts or to sell municipal securities. For the reasons explained above, the Board concludes that significant adverse effects are not likely to result from the proposal and, accordingly, the Board finds that the imposition of the restrictions advanced by the SIA is not warranted. Because BAC's plans to finance and promote Schwab and to place Schwab offices at

some BAC locations are not likely to produce any unfair competitive advantage, public confusion, or other adverse effects, the Board finds no basis to restrict such activities. Also, Bank's use of Schwab to buy or sell securities as agent for the Bank's trust department or to transmit information on Bank's municipal securities inventory should not be prohibited, since these operations present the prospect of no serious adverse effects.[56]

In approving BAC's application to acquire Schwab, the Board grants approval under the BHC Act only for those activities considered by the Board.[57] Thus, any change or expansion in the activities described in this Order would require the approval of the Board.

Consistency with Objectives of the BHC Act

The Board has reviewed this application from the viewpoint of its basic consistency with the objectives of the BHC Act. This Act was designed to eliminate the potential for conflicts of interest and concentration of resources that are inherent in the commingling of banking and commerce to help maintain banks as impartial providers of credit, to avoid the anticompetitive effects that would inevitably arise from close links between the control and use of credit, and to protect the banking system and ultimately the economy as a whole from the instability that could result from bank participation in commerce. The Board believes that these fundamental considerations retain their essential validity and should continue to guide the evolution of banking services in the changing economic and competitive environment that we have today.

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56 Indeed, a complete prohibition against Bank's use of Schwab's brokerage service could conceivably cause a breach of fiduciary duty in a particular case where Schwab in fact can provide the best execution of the order. Moreover, there is no indication that Schwab will not comply with the limitations that the SEC and other authorities have prescribed on the receipt by brokers of funds solely to earn interest. A similar Board-imposed limitation is unnecessary.

57 12 C.F.R. § 225.4(c)(2).

The Board finds that there is no inconsistency between the basic policies of the BHC Act and the conduct of the nonbanking activity that is the subject of this application. As described in detail in this Order, the Board has found that a securities brokerage service that is essentially confined to the purchase and sale of securities for the account of third parties, and without the provision of investment advice to the purchaser or seller, does not raise the potential for conflicts of interest or concentration of resources that were the object of the prohibitions that were instituted to assure the separation of banking from commerce. Expansion of banking into securities activities must proceed carefully, but the proposed activity raises none of the concern that engenders the need for restrictions on banking or bank holding company activities.

Based upon the foregoing and other considerations reflected in the record, the Board has determined that the public benefits associated with consummation of this proposal can reasonably be expected to outweigh possible adverse effects, and that the balance of the public interest factors, which the Board is required to consider under section 4(c)(8) of the Act, is favorable. Accordingly, the application is hereby approved.

This determination is subject to the conditions set forth in section 225.4(c) of Regulation Y and the Board's authority to require such modification or termination of the activities of a holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder, or to prevent evasion thereof.

Because of the extensive consideration accorded to Schwab's securities brokerage, margin lending, and incidental activities in the context of this application, and having determined that the public interest considerations of section 4(c)(8) favor approval of BAC's proposal, the Board has determined that further applications by BAC to extend Schwab's retail discount securities brokerage, margin lending, and incidental activities to additional offices may be processed in the same manner as other *de novo* applications under the provisions of section 225.4(b)(1) of Regulation Y (12 C.F.R. § 225.4(b)(1)). Author-

ity is hereby delegated to the Federal Reserve Bank of San Francisco to take action on such notices properly filed as prescribed in that section.

The proposed activities shall not commence later than three months after the effective date of this Order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco.

By order of the Board of Governors,[58] effective January 7, 1983.

(Signed) James McAfee

James McAfee
Associate Secretary of the Board

[SEAL]

58 Voting for this action: Chairman Volcker and Governors Martin, Wallich, Partee, Rice and Gramley. Absent and not voting: Governor Teeters.

RELEVANT PROVISIONS OF THE BANKING ACT OF 1933 (THE GLASS-STEAGALL ACT)

SECTION 16

12 U.S.C. § 24. Corporate Powers of Associations

Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * *

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, co-partnership, association or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permit-

ted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or . . .

SECTION 20:

12 U.S.C. § 377. Affiliation with Organization Dealing in Securities; Penalties

After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

SECTION 21:

12 U.S.C. § 378. Dealers in Securities Engaging in Banking Business; Individuals or Associations Engaging in Banking Business; Examinations and Reports; Penalties

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this para-

graph shall not prohibit national banks or state banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: *Provided further,* That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate;

* * *

SECTION 32:

12 U.S.C. § 78. Certain Persons Excluded from Serving as Officers, Directors or Employees of Member Banks

No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

RELEVANT PROVISIONS OF THE BANK HOLDING COMPANY ACT

12 U.S.C. § 1843. Interests in Nonbanking Organizations

(a) Ownership or control of voting shares of any company not a bank; engagement in activities other than banking. Except as otherwise provided in this Act no bank holding company shall—

(1) after the date of enactment of this Act [enacted May 9, 1956], acquire direct or indirect ownership or control of any voting shares of any company which is not a bank,

* * * * * *

(c) Exemptions. The prohibitions in this section shall not . . . apply to—

* * * * * *

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

Joint Appendix

No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JOINT APPENDIX

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Chronology of Relevant Pleadings, Hearings, and Orders in the Court Below*

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—against—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents,

and

BANKAMERICA CORPORATION,

Intervenor.

ON PETITION FOR REVIEW OF ORDER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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* Because the Clerk of the United States Court of Appeals for the Second Circuit is unable to locate the actual docket of this proceeding, this chronology was prepared by counsel for petitioner based upon a computer-generated "General Docket" provided by the Clerk.

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Chronology

Date	*Filings-Proceedings*
2-3-83	Petition filed for review of final agency action
2-22-83	Pre-argument conference held with Frank J. Scardilli, Staff Counsel
2-22-83	BankAmerica Corp. Motion for Leave to Intervene on Consent
2-25-83	Scheduling Order entered
2-28-83	Certification of Index of Administrative Record filed
3-1-83	Order entered granting Motion to Intervene on Consent
3-16-83	Petitioner's Brief filed
3-16-83	Record materials designated by Petitioner to be included in the Joint Appendix filed
4-11-83	Record materials designated by Respondents to be included in Joint Appendix filed
4-11-83	Record materials designated by Intervenor to be included in Joint Appendix filed
4-11-83	Respondents' Brief filed
4-11-83	Intervenor's Brief filed
4-25-83	Petitioner's Reply Brief filed
5-23-83	Argued before Feinberg, C.J.; Lumbard, and Winter J.J. (15 minutes allocated to each side)
7-15-83	Opinion for the Court filed by Circuit Judge Lumbard
7-15-83	Judgment entered that the Petition be denied, in accordance with the Opinion for the Court filed on this date

Chronology

Date	*Filings-Proceedings*
7-27-83	Intervenor's Bill of Costs filed
7-28-83	Respondents' Bill of Costs filed
8-22-83	Mandate issued
9-20-83	Order amending Opinion filed

Recommended Decision of Administrative Law Judge, dated November 12, 1982

UNITED STATES OF AMERICA

BEFORE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

November 12, 1982

DOCKET NO. R-0398

In the Matter of

APPLICATION BY BANKAMERICA CORPORATION

To Acquire

THE CHARLES SCHWAB CORPORATION

RECOMMENDED DECISION

Ernest G. Barnes
Administrative Law Judge

UNITED STATES OF AMERICA

BEFORE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

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In the Matter of
APPLICATION BY BANKAMERICA CORPORATION

To Acquire
THE CHARLES SCHWAB CORPORATION

RECOMMENDED DECISION

Ernest G. Barnes, Administrative Law Judge

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IN THE MATTER OF
APPLICATION OF BANKAMERICA CORPORATION
TO ACQUIRE
THE CHARLES SCHWAB CORPORATION

Docket No. R-0398

Recommended Decision

Recommended Decision

Recommended Decision

PRELIMINARY STATEMENT

On February 8, 1982, BankAmerica Corporation, San Francisco, California ("BAC"), applied pursuant to Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. § 1843(c)(8)), and Sections 225.4(a) and (b)(2) of the Federal Reserve Board's Regulation Y (12 CFR §§ 225.4(a) and (b)(2)), for permission to acquire directly all of the voting shares of The Charles Schwab Corporation, San Francisco, California, and thereby indirectly acquire Charles Schwab & Company, Inc., San Francisco, California (together "Schwab").

The BAC application sought a determination by the Board that retail agency brokerage and the extension of margin credit were permissible activities for a nonbank subsidiary of a bank holding company (BAC Application at 3, 19-23). BAC also requested the Board to determine that several activities of Schwab, including account maintenance, payments of interest on net free balances, custodial services and its Kemper sweep arrangement, are incidental to brokerage and permissible activities under the Act (*Id.* at 13-14, 23-25).

By notice published in the *Federal Register* on April 14, 1982, the Board invited interested persons to express their views on whether: (1) the proposed activities are so closely related to banking or managing or controlling banks as to be a proper incident thereto; (2) the proposed activities are permissible under the Glass-Steagall Act (i.e., 12 U.S.C. §§ 24, 78, 377 and 378(a)), which is designed to separate commercial from investment banking; and, (3) consumation [sic] of the proposal can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. Parties requesting a hearing were directed to state why a written presentation would not suffice in lieu of a hearing, to

identify specifically any disputed question of fact, and to summarize the evidence that would be presented at a hearing.

Eighty-one comments were filed with the Board. Altogether, 64 commentors, including the Department of Justice, the Securities and Exchange Commission, and six federal reserve banks, supported the application. Among the 17 commentors who filed in opposition to the application was the Securities Industry Association ("SIA"), a national trade association of securities brokerage and investment banking firms, which on May 28, 1982, filed a memorandum urging that BAC's application be denied and requesting a formal hearing (SIA Opposing Memorandum at 48). SIA argued that the proposed activities had never been conducted by banks or bank holding companies to the extent proposed by BAC, and therefore may not be considered "closely related" to banking within the meaning of section 4(c)(8) of the Bank Holding Company Act. Additionally, SIA claimed that the proposed activities are precluded by Sections 16 and 20 of the Glass-Steagall Act. Finally, SIA disputed the public benefits alleged by BAC to accompany its proposal and claimed several possible adverse effects of permitting the merger, such as an undue concentration of resources, a lessening of competition among discount brokers, unfair competition due to Schwab's affiliation with a bank, voluntary tying and possible public confusion. In the event the Board chose to approve the acquisition SIA urged that conditions be placed upon the approval in order to minimize the risks involved (*Id.* at 41-42). By letter dated June 21, 1982, BAC opposed SIA's request for a hearing stating that no disputed material facts had been raised in connection with its proposal.

On July 6, 1982, the Board determined that while SIA's questions might appropriately be resolved through additional written submissions, a public and formal hearing conducted pursuant to an agreed-upon time schedule of the parties would provide an appropriate means to develop a full record for Board consideration of any disputed material fact involved in

BAC's proposal. The Board, accordingly, ordered such a hearing to commence September 13, 1982, [1] and established the following schedule (Order for Hearing at 4):

July 19, 1982	Production of Information response to the requests of the parties
August 18, 1982	Submission of Direct Testimony
September 13-17, 1982	Hearing
October 1, 1982	Submission of Briefs and Proposed Findings of Fact
October 12, 1982	Submission of Reply Briefs
November 12, 1982	Filing of Recommended Decision
November 24, 1982	Filing of Exceptions

With the consent of the parties, the Department of Justice was permitted to intervene in the proceeding (Prehearing Conference of August 5, 1982 at 10; Order Resulting From Prehearing Conferences of August 5, 1982 and August 19, 1982, dated August 20, 1982).

On July 7, 1982, BAC filed a request for production of documents from SIA; on July 12, 1982, SIA filed a request for production of documents from BAC and Schwab. An informal meeting among the parties and Board counsel was held on July 13, 1982, to discuss the scope of the respective production requests and establish procedures for confidential treatment of documents produced. By order of the Board dated July 19, 1982, a protective order to cover confidential documents produced in this matter was issued. Complete accord on either of the requests for production of documents was not reached, and SIA filed a memorandum dated July 16, 1982 that opposed

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1 This date was later moved forward, with the consent of the parties, to September 8, 1982.

BAC's discovery request; similarly, by letter dated August 2, 1982, counsel for BAC objected to SIA's proposed treatment under the protective order of documents produced and the relevance of certain of the documents. The differences relating to SIA's document requests were resolved by the parties (Order dated August 20, 1982). However, BAC and SIA were unable to resolve their differences as to the document request by BAC to SIA members. Therefore, it was determined that subpoenas *duces tecum* would issue at the request of BAC to the following SIA members: Merrill Lynch & Co., Inc., The E. F. Hutton Group, Inc., Dean Witter Reynolds Organization Inc., Bache Halsey Stuart Shields Incorporated, Paine Webber Incorporated, The Drexler [sic] Burnham Lambert Group Inc., and Shearson Loeb Rhodes, Inc. (*Ibid.*).[2] At a prehearing conference held on September 1, 1982, the subpoenas were substantially modified and as modified compliance was ordered (Prehearing Conference of September 1, at 3, 78). On September 9, 1982, five of the subpoenaed parties (excluding Shearson Loeb Rhodes, Inc.) filed with the Board a motion for permission to appeal the denial by the administrative law judge of a motion to quash the subpoenas. The parties subsequently resolved the subpoena controversy and BAC received and offered in the record affidavits by the SIA members in lieu of document production pursuant to the modified subpoenas (BAC Exhs. 82-87).

By order dated July 19, 1982, the undersigned administrative law judge was designated as the presiding officer in this matter. Prehearing conferences were held on August 5, August 19 and September 1, 1982. Two orders dated August 20, 1982 were issued rescheduling the hearing dates and disposing of other procedural matters. The hearing commenced at the Board's offices in Washington, D. C. on Wednesday, September 8, and concluded on Thursday, September 16, 1982. In all there were six days of hearings.

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2 Subpoenas *duces tecum* to the referenced companies were issued on August 19, 1982.

During the course of this proceeding written direct testimony was filed by 20 witnesses, nine of whom submitted written rebuttals and one written redirect. Over 130 exhibits were submitted by the parties, some of which were received under seal pursuant to a protective order dated July 19, 1982, issued by the Board. Eight witnesses were cross-examined in public hearings before the administrative law judge during the course of six days of trial. The transcript of record consists of 1,124 pages.

After having heard and observed the witnesses and after having carefully reviewed the entire record in this proceeding, including all written testimony and documentary evidence submitted by the parties together with all proposed findings of fact and conclusions of law and supporting memoranda, the administrative law judge makes the following findings of fact and conclusions and issues the Recommendation set out at the end hereof.

FINDINGS OF FACT

I. *Identification of Parties*

A. *The BankAmerica Corporation*

1. BAC was organized in 1968 and became the holding company of the Bank of America NT&SA (the "Bank") in 1969. Measured by assets, BAC is the second largest bank holding company in the United States (Prussia Direct at 2, 3).

2. The Bank is BAC's principal subsidiary (SIA Exhs. 1, 12). It is the largest bank in the United States and the dominant financial institution in California (Mussa Direct at 47-48; Mussa Rebuttal at 41; Mussa Tr. at 651-652). Other subsidiaries of BAC include FinanceAmerica Corporation, Decimus Corporation, and BA Mortgage and International Realty Co. (McLin Tr. at 27). These subsidiaries engage in a variety of activities throughout the United States, primarily consumer and commercial lending, mortgage banking, leasing,

data processing, investment advisory services, and certain credit-related insurance underwriting and insurance agency activities (Prussia Direct at 3).

3. At year-end 1981, BAC had total assets of $121,158 million, of which $112,325 million are assets of the Bank (Mussa Rebuttal at 28; SIA Exh. 1 at 4; SIA Exh. 2 at 2). BAC had net income of $445.4 million in 1981, down from $645 million in 1980 (SIA Exh. 1 at 7). The Bank's net income for 1981 accounted for 88.15% of the total net income of its parent, BAC (SIA Exh. 1 at 35; Mussa Direct at 7). At the end of 1981 BAC reported $4,091 million of equity capital, while the Bank's equity capital amounted to $4,048 million, or 98.9% of the equity capital of BAC (Mussa Direct at 7; SIA Exh. 1 at 4; SIA Exh. 2 at 2).

4. The Bank operates more than 1,100 branches throughout the State of California and engages in a full range of commercial banking activities. Over 3 million households in California are BAC customers. The Bank offers its customers various depository services, trust services, and a wide variety of real estate, consumer-related and commercial loans. Through its branches, loan production offices, and an Edge Act subsidiary, and through over 100 foreign branches and various foreign subsidiaries and affiliates, the Bank offers business customers a full range of domestic and international banking services throughout the United States and abroad (Prussia Direct at 3; SIA Exh. 7 at 5).

5. The Bank's 1981 California domestic deposits totalled $51,944 million, which represents 35.8% of all bank deposits in the State of California (SIA Exh. 37 at 111; Mussa Rebuttal at 30). When California savings and loan association deposits are added to bank deposits, the Bank's share of total deposits becomes 20.2% (Mussa Rebuttal at 32).

6. At the end of 1981 the Bank had 33.3% of total loans in domestic offices of California banks (SIA Exh. 37 at 6; Mussa Rebuttal at 30). In bank loans the Bank's percentages range

from 29.7% to 37.1%, depending on the category of loan (SIA Exh. 37 at 6; Mussa Rebuttal at 31).

B. *Charles Schwab & Co., Inc.*

7. Schwab was founded in California in 1971. It is a securities brokerage firm registered pursuant to Section 15 of the Securities Exchange Act of 1934 (Schwab Direct at 1-2). Schwab is qualified as a broker-dealer in all fifty states and the District of Columbia (Stupski Direct at 3). Schwab is a member of various securities exchanges. It has two seats on the New York Stock Exchange; one seat on the Chicago Board Options Exchange; two seats on the Pacific Stock Exchange; and is represented on the floors of other exchanges (Stupski Tr. at 96-98). Until June 1982, Schwab relied on Pershing & Co. to execute and clear its trades on the New York Stock Exchange, and Schwab still uses Pershing for its options trading (Stupski Direct at 3; Stupski Tr. at 66).

8. Schwab became a discount broker when all brokerage commissions were unfixed on May 1, 1975 and Schwab reduced its commissions for all transactions (Schwab Direct at 1-2). Schwab is the largest discount broker in the United States (Stupski Direct Exh. 1, 11; SIA Exh. 41 at 4; Mussa Rebuttal at 38-39). It has 51 offices in 26 states and the District of Columbia. Nine of its offices and its headquarters are in California. Schwab has recently opened a foreign office in Hong Kong (Schwab Direct at 5). Schwab currently has approximately 300,000 customers, virtually all of whom are individuals or small corporations (Schwab Direct at 4).

9. Most of Schwab's transactional business is conducted by telephone. Schwab maintains at least 80 toll-free numbers which enable its customers (and potential customers) to call it from all parts of the United States, either to obtain information about opening an account, or to conduct transactions once they have an account. An account can be opened entirely by mail. In response to telephone inquiries, Schwab sends out a

package of all the materials a customer needs to open an account, which the customer can fill out and return to Schwab. Schwab assigns no personal broker to a customer and makes no investment recommendations. Stupski Direct Exh. 1 contains a brochure that provides a general overview of Schwab's activities (Stupski Direct at 2-3; SIA Exh. 41 at 7).

10. In 1981, Schwab received over $29 million in commission revenues (Schwab Direct at 12). This represents approximately 9% of the commissions received by all discount brokers (SIA Exh. 41 at 4; SIA Exh. 7 at 4), but less than 1% of all retail securities brokerage commission revenues (Mussa Rebuttal at 39; BAC Application at 4). The bulk of Schwab's business is security transactions involving equity securities (Stupski Tr. at 96).

11. On June 30, 1982, Schwab had $125 million in assets, $12 million in shareholders' equity, and $9 million in net capital computed pursuant to the rules of the Securities and Exchange Commission under § 15 of the 1934 Act (Schwab Direct at 5-6). Schwab has experienced rapid growth in recent years. Between 1979 and 1981 its assets have doubled (SIA Exh. 41 at 4, 8). Over the past five years Schwab's commission revenues have grown at a compound rate of 70% and it [sic] revenues have grown at a compound rate of 77%. Over the past four years its pre-tax income has grown at a 90% compound rate (SIA Exh. 41 at 4). In its Iatest [sic] fiscal year, Schwab's return on average equity was nearly 30% (SIA Exh. 59 at 2).

12. Schwab buys and sells securities solely on the order and for the account of customers. It does not engage in market making or more than a minimal amount of dealing or underwriting, and it gives no investment advice. Incidental to its brokerage activity, Schwab extends margin loans to customers, offers custodial services, a self-directed IRA account, carries customer credit balances, on some of which it pays interest, and maintains an arrangement whereby customers may invest

temporarily free balances in an unaffiliated money market fund (BAC Application at 4; McLin Direct at 9; Stupski Tr. at 60). Schwab offers a wider range of services [sic] other discount brokers (Stupski Tr. at 115).

13. The only securities transactions in which Schwab engages that might be characterized as other than agency transactions are the "inadvertent principal" transactions that arise as a result of errors in executing customer orders and the "riskless principal" transactions in connection with the purchase and sale of new issue municipal bonds in Schwab's Munimart service (Stupski Direct at 13-15; Stupski Tr. at 95; *see also* F. 64, 65).

14. Employee compensation by Schwab is based, in part, on volume of business done in an individual office and Schwab's overall volume. There is no compensation for volume of sales by specific individuals (Stupski Direct at 18-19; Stupski Tr. at 90-92, 125).

15. Schwab's employee handbook states that the firm does not give advice or counsel people on investments. An employee who is found giving advice to customers could be terminated for cause (Stupski Tr. at 126).

C. *Securities Industry Association*

16. SIA is a national trade association representing over 540 organizations responsible for over 90% of the securities brokerage and investment banking business of the nation. SIA's membership is a cross-section of the securities business encompassing members of national securities exchanges as well as firms which are not members of such exchanges. The business of its members includes retail and institutional brokerage, over-the-counter market making, underwriting and other investment banking activities, and various exchange floor functions (SIA Opposing Memorandum at 1).

D. *Department of Justice*

17. The Department of Justice represents the interests of the United States Government. The Department was permitted to intervene after having filed comments with the Board as to the propriety of the acquisition. The Department has certain expertise in the area of unfair competition and it is therefore a proper party to this proceeding (Prehearing Conference of August 5, 1982, at 4-7; Order Resulting From Prehearing Conferences of August 5, 1982 and August 19, 1982, dated August 20, 1982).

E. *Federal Reserve Board*

18. Congress has conferred upon the Board of Governors of the Federal Reserve System the authority and the duty of determining "after due notice and opportunity for hearing" whether proposed acquisitions by bankholding [sic] companies are permissible under the Bank Holding Company Act (12 U.S.C. § 1843(c)(8)). The General Counsel's Office of the Board participated in this proceeding and has filed proposed findings of fact and supporting memoranda.

II. *The Brokerage Industry*

19. According to the SEC's staff report on the securities industry, as of 1980 there existed 2,444 broker-dealers whose securities-related activities brought them into contact with the investing public. New York Stock Exchange ("NYSE") members represent only 16% of total number of firms doing public business in 1980, but their revenues comprised 86% and their assets 92% of the industry's total (BAC Exh. 55 at 15 [SEC Staff Report on "The Securities Industry in 1980"]).

20. Revenues of the securities firms doing a public business reached $18.6 billion and pre-tax income increased to $2.7 billion in 1980. These figures represent 40.7% and 85.0% increases respectively over a profitable 1979. Securities commissions continued to be the most imported [sic] source of

revenues, accounting for 34.3% of total revenues. They increased by 41.3% to $6.4 billion in 1980, reflecting the 42.0% increase in the number of shares, rights and warrants traded on all exchanges and the 84.3% increase in NASDAQ volume (*Id.* at I5-I6 [sic]).

21. Historically, securities commission income has been the mainstay of the industry, consistently supplying more revenues than any other source. But while revenues from commissions have increased by 75% since 1972, other revenue sources have taken on increased importance. Commission revenues comprised 35.5% of total revenues in 1980 compared to their 1972-1980 high of 55.3% in 1973. One factor in this decline was the elimination of fixed rates in 1975 and the ensuing decline in commission rates. Other factors include rising interest rates and diversification on the part of broker-dealers, which have contributed to the rapid growth of interest revenues and "all other revenues" (*Id.* at 20-21).

22. Revenues from margin financing reflect the level of interest rates, the volume of market activity, margin requirements and investor preference for leverage. A rapid increase in the volume of margin debt since 1975, in conjunction with the upward trend in interest rates, has led to an increase in margin interest income as a proportion of total revenues. This revenue source contributed 7.8% of total revenues in 1974, its 1972-1980 low, and 14.7% in 1979. With margin debt and interest rates both increasing, this revenue source grew in absolute terms in 1980, but declined as a proportion of total revenues (*Id.* at 21).

23. There has been a long-term trend toward consolidation within the securities industry. This consolidation initially took place as firms perceived the need to strengthen their financial structure and to create a more permanent capital base. This trend has intensified in recent years in response to firms' desires to diversify their operations in order to compete more sucessfully with other diversified financial companies, to stabi-

lize earnings, to enhance growth prospects, and to achieve operating advantages through economies of scale in such areas as data processing, communication, advertising and marketing. A corollary effect of such consolidation, however, has been an increasing concentration of industry revenues (*Id.* at 79).

24. The consolidation that has occurred has affected a wide spectrum of broker-dealers. For example, the relative size of the largest four firms increased from 18% to 24% of total revenues from 1971 to 1980. During this period, the fifth through the eighth largest firms grew from 7% to 13% of total revenues, while corresponding figures for the ninth through the sixteenth largest firms were 11% and 15%. Measuring firm size in terms of assets provides similar results. This suggests that increasing concentration in the securities industry is not the result of several large firms edging towards a strong oligopoly, but rather expansion, through consolidation or growth, of a number of firms attempting to achieve economies of scale, diversification, and an expanded capital base (*Id.* at 80).

25. The largest firms in the securities industry tend to conduct their business in many different geographic areas of the nation. Although their penetration of these geographic markets varies considerably, it is noteworthy that they face substantial competition from smaller firms (principally regional firms) in all of them. Thus, the securities industry appears to remain competitive in terms of structure, as well as conduct and performance (*Ibid*).

26. Since May 1, 1975, when fixed commission rates were eliminated, commission rates have generally decreased for institutional as well as individual investors. The two principal factors influencing the commission charge on a particular order are (1) the volume of commission revenues generated by the account and (2) the size of the order. Clients who do considerable business with a firm are sometimes able to negotiate rate reductions on brokerage transactions. Institutions

usually generate much more commission revenue per account than individuals and their rates reflect this. In addition, effecting transactions for a client on a regular basis may reduce brokerage costs. This explains, in part, the lower charges institutions pay for smaller transactions. Increasing order size leads to higher commissions, but as fixed costs are spread over a larger order, commissions increase less than order size and the commission rate declines (*Id.* at 82-83).

27. The behavior of commission rates since April 1975 differed considerably, depending on the client type or order size. Institutions experienced the most substantial reduction in rates. Rates were reduced across all transaction sizes, and while commission charges for larger orders declined at a more rapid rate, commission rates on even the smallest orders were substantially reduced. While commission rates for individuals also declined, this decrease was not as impressive as that for institutions and did not occur across all order sizes. The overall decline in commission rates for individuals was due to reductions in the commissions charged for large orders only, as well as an increase in the proportion of large orders. The rates charged on small orders have increased (*Ibid*).

28. Overall, commission rates remained virtually unchanged during 1980, with individuals experiencing a slight decline and institutions exhibiting mixed results. Commission rates both as a percent of principal value and per share declined for individuals while commission rates for institutions decreased as a percent of principal value and increased per share (*Id.* at 83).) [sic].

29. Prior to 1975, broker-dealers discounting commissions on brokerage transactions for retail customers were limited to offering discount commission rates on OTC transactions or operating as intermediary agents between clients and "third market" dealers. The elimination of fixed commission charges in May 1975 expanded opportunities for discount brokers considerably by making it possible for NYSE member firms to offer discount commission rates on transactions in NYSE-

listed stocks and by enabling brokers who were not NYSE members to negotiate access to the NYSE at lower rates (*Id.* at 85).

30. Discount brokers [sic] share of retail commission revenues has grown steadily from 3.5% in 1977 to 6.1% by the fourth quarter of 1980.[3] Commission revenues of these firms grew by 345% during this period, as compared to a 214% increase in retail commissions for all firms doing a public business. The surge in trading activity during 1980 benefitted discount brokers more than the industry in general. While retail commission revenues for the industry increased 40% from 1979 to 1980, that of discount brokers increased 74% (*Id.* at 86-87).

31. As the discount brokerage segment of the industry has matured, profitability has become more elusive for new firms. The discount broker-dealers established in 1977 and 1978 experienced a median of 1.75 and 1.0 unprofitable quarters, respectively, before their first profitable one. However, the firms established in 1979 required a median of 4.0 unprofitable quarters before their first profitable one. Nevertheless, the number of discount brokers continue [sic] to expand, attracted largely by the superior profits obtained by the more seasoned firms (*Id.* 87).

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3 Two assumptions were necessary to estimate the discount broker-dealers' share of commission revenues. First, these estimates assume that the industry has a retail/institutional commission revenue split equal to that of the firms reporting in the Commission's Survey of Commission Charges on Brokerage Transactions. This proportion varied from a low of 62% in the second quarter of 1980 to a high of 69% in the fourth quarter. A second assumption is that discount broker-dealers have only a retail business. It is possible that small institutions also may find commission rates at discount firms attractive if research and other aspects of the full-service package are unimportant to the institution. In this event, the commission share estimates of discount brokers would be somewhat overstated.

III. *Securities Activities Presently Conducted by Banks*

A. *In General*

32. On January 3, 1977, the Securities and Exchange Commission ("SEC") issued its "Initial Report On Bank Securities Activities" (BAC Exh. 53). This report stated:

> "Banks historically have played a major role in securities activities and the securities markets. While the permissible range of bank securities activities was circumscribed by passage of the Glass-Steagall Act in 1933, that Act did not separate the business of commerical banking from all aspects of the securities business. Banks act as underwriters of, and dealers in, U.S. government and municipal securities, manage the investments of others as trustee and agent, and are actively involved in the handling of securities and in the settlement of securities transactions for broker-dealers, institutional customers and others.
>
> "Although the Glass-Steagall Act placed restrictions on banks' dealings in corporate securities, the extent of their activity in purchasing corporate stock as agents for their customers has increased in recent years. In the years since 1968, a period of declining individual ownership of corporate securities, more than one million investors began using the services of banks to buy corporate securities. Banks also have shown a willingness to innovate in offering securities services. While some of the bank securities services described in this report have not been successful, others, such as dividend reinvestment plans, have been well received.
>
> "While bank securities services are comparable to and competitive with services offered by broker-dealers, banks are excluded from the definitions of 'broker' and 'dealer' in the Securities Exchange Act of 1934 (the 'Exchange Act'). Banks therefore are excluded from registration with, and regulation by, the Commission, with the result that securities regulations relating to execution and confir-

mation of transactions, the handling of customers' funds and securities, advertising and other activities do no [sic] apply equally to banks and broker-dealers offering similar services. The concern regarding these regulatory differences prompted this Study." (BAC Exh. 53 at 9)

33. On June 30, 1977 the "SEC" issued its "Final Report On Bank Securities Activities." This report was prepared at the direction of Congress as a study of the extent to which banks maintain accounts on behalf of public customers for buying and selling publicly-traded securities and whether the exclusion of banks from the Securities Exchange Act of 1934 definitions of "broker" and "dealer" is consistent with the protection of investors and the other purposes of that Act.[4] The bank securities activity studied by the SEC "falls generally into three categories: bank brokerage-type services, utilized primarily by individual investors; bank trust department securities trading activities, primarily for personal trust, personal agency and employee benefit accounts; and bank corporate financing services for corporations and other business organizations" ("Final Report On Bank Securities Activities, Pursuant To Section 11A(e) of the Securities Exchange Act of 1934," June 30, 1977, [BAC Exh. 54 at 1-2]). The SEC's report presented detailed analyses of four bank-sponsored securities services which are similar to services offered by broker-dealers: dividend reinvestment plans, employee stock purchase plans, automatic customer purchase plans and customer transactions service. The report further stated:

"The common element of the bank securities services studied is that banks providing the services, like brokers,

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4 Section 3(a)(4) of the Securities Exchange Act defines the term "broker" as follows:

The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank. 15 U.S.C. § 78c(a)(4) (1970).

are engaged in effecting transactions in securities for the account of others . . . . [footnote omitted] In considering the continued advisability of the Exchange Act exclusions for banks, the Commission's primary focus has been upon the protection of investors using these services. This has involved an analysis of the manner in which specific bank securities activities are conducted, recognizing that in some respects bank services are functionally equivalent to those of broker-dealers, while in other respects they are not." (BAC Exh. 54 at 3).

34. Four brokerage services have been provided by banks: (1) Customer Transaction Services ("CTS"); (2) Dividend Reinvestment Plans ("DRP"); (3) Employee Stock Purchase Plans ("ESPP"); and (4) Automatic Investment Services ("AIS"). The estimated market value of the transactions represented by these four types of services as a percentage of all transactions on national stock exchanges is 0.9% (BAC Exh. 53 at 10-11, 13; Mussa Direct at 26; SIA Exh. 45 at 6-7).

35. Customer Transaction Services are the most flexible of bank investment plans, allowing customers to place orders to buy or sell virtually any stock. After accepting a customer's order, the bank transmits the order to a broker-dealer for execution and handles the clearance and settlement of the transaction. The SEC's "Initial Report on Bank Securities Activities" concluded that as of 1976, more than 4,300 commercial banks (30% of banks) offered CTSs (BAC Exh. 53 at 4, 13, 85-86; Mussa Direct at 26-27). Banks have traditionally offered CTSs as an accommodation to their customers who have accounts with the banks. They are usually provided on an informal basis and are not advertised. Viewed alone, they are not profitable; nevertheless, the services are offered by more banks than all other formal services combined (BAC Exh. 53 at 86).

36. Dividend Reinvestment Plans provide an opportunity for shareholders to reinvest dividends received on their shares.

Many DRPs also provide shareholders the option of investing other funds in the purchase of additional stock. Banks administer DRPs by holding shares for the account of the participants and acquiring additional shares in the market or, in some instances, through direct purchases of stock from the issuer. DRPs were first offered by banks in 1968, and as of 1977, 68 banks (0.5% of all banks) administered such plans for 727 companies. An estimated 1,900,000 individuals have participated in these plans (Drew Direct at 1-2; Jacobs Direct at 10; BAC Exh. 53 at 13, 15).

37. Employee Stock Purchase Plans provide employees of an issuer an opportunity to invest a predetermined amount in the stock of their employer through voluntary periodic payroll deductions. Banks administer these plans by holding the shares for the account of the participants and acquiring the necessary shares in the market or, in some instances, through direct purchases from the issuer. The first ESPP was offered by a bank in 1953; as of 1977, 59 banks (0.4% of all banks) provided such services (Jacobs Direct at 10; BAC Exh. 53 at 13, 36-37).

38. Automatic Investment Plans provide participants the opportunity periodically to invest predetermined amounts in equity securities selected by them from a list compiled by the administering bank. Banks administer these plans by holding the shares for the account of the participants and purchasing the necessary shares in the market. AIPs were first introduced in mid-1973. By purchasing large numbers of shares at one time, the bank was able to pass substantial savings in transactions on to individual purchasers. Since the unfixing of brokerage commissions in 1975, AIPs have not been profitable and have been discontinued by most banks that offered them. As of 1977, 18 banks (0.1% of all banks) provided the service (Jacobs Direct at 11; BAC Exh. 53 at 13, 54-59; Mussa Tr. at 595).

39. A large proportion of bank securities transaction activities are provided by bank trust departments. These securities activities are comparable to and competitive with many services offered by broker dealers. Bank trust departments offer services to a wide variety of customers, including individual trusts and estates, pension funds, and profit sharing and other benefit plan funds. Services provided to bank trust department customers include the holding of securities for their accounts, investment advice, and the arrangement for the purchase and sale of securities. Bank trust departments maintain custody of the securities, collect dividends and credit them to an interest-bearing account. The bank may or may not offer investment advice to the customer (i.e., the owner or others responsible for investment decisions for the account). In any event, the bank, acting as agent, executes the investment instructions of the customer and purchases and sells securities for the account accordingly (Ireland Direct at 1, 5; Mussa Tr. at 1008; BAC Exh. 54 at 135-43). These activities are in many respects the functional equivalent of those performed by retail brokerage firms (Ireland Direct at 2, 5; Jacobs Direct at 11-12). As the SEC's "Final Report on Bank Securities Activities" (June 30, 1977) stated:

> ". . . with respect to the purchase and sale of securities for their managed accounts, bank trust departments are performing in many respects the same activities as are performed by retail brokerage firms. They are effecting transactions in securities for the account of others. Like brokers, trust departments are intermediaries (as agents or trustees) between their clients' accounts and third persons with whom they effect securities transactions. While in a majority of cases bank trust departments do not deal directly with such third persons, but rather hire a broker to make that connection, that fact differentiates them from brokers only by degree: for example, forwarding or "corresponding" brokers effect transactions by going to another broker to consummate an execution. In addition,

to a significant degree banks effect securities transactions without using brokers at all. For example, in a significant minority of cases trust departments negotiate directly with dealers to effect transactions. In some cases they effect transactions directly with other institutions or entirely in-house by crossing orders between two or more accounts. . . ." (BAC Exh. 54 at 121-122).

40. While in a majority of cases bank trust departments employ a broker for some role in most of their securities transactions, the SEC has found that ". . . in a significant minority of cases trust departments negotiate directly with dealers to effect transactions. In some cases they effect transactions directly with other institutions or entirely in-house by crossing orders between two or more accounts." (BAC Exh. 54 at 122; *see also* Ireland Direct at 2-5). In transactions involving large orders of listed securities (as well as transactions involving the crossing of buy and sell orders of bank customers), trust department trading desks are actively involved in arranging the transaction, and often use a broker only to perform the formal execution (Ireland Direct at 2-5; BAC Exh. 54 at 173-75).

41. Banks are permitted to underwrite and deal in obligations of the United States and its agencies, general obligations of states and municipalities, and certain limited types of municipal revenue bonds. Banks are active participants in the markets for such securities (Wiatrak Direct at 2-10; Baxter Direct at 12-13), and have been very important as underwriters and dealers of municipal securities for institutional investors (Mussa Tr. at 599). Banks also engage extensively in money market instruments such as negotiable certificates of deposit and bankers [sic] acceptances (Baxter Direct at 7-20; Biller Tr. at 235, 237; Jacobs Direct at 7-13; Jannotta Rebuttal at 11-16; Mussa Direct at 26-29; BAC Exh. 53 at 9).

42. Recently, a large number of banks have begun to provide expanded brokerage services to their customers pursuant

to contractual arrangements with securities brokerage firms, including discount brokerage firms (Baxter Direct at 11, n.1; Biller Direct at 18-20; Biller Tr. at 253; Jacobs Direct at 13). Security Pacific National Bank recently entered into an arrangement with Fidelity Brokerage Services in Boston to provide discount brokerage services through Security Pacific's more than 600 branches. A number of other banks also have arrangements with Fidelity to provide securities transactions at discount rates. Chemical Bank recently entered into an arrangement with Donaldson, Lufkin & Jenrette to provide stock and bond brokerage services, margin loans, and other financial services in the New York Metropolitan area. Citibank has entered into a joint venture with Quick & Reilly, Inc. to provide brokerage services to that bank's customers (Baxter Direct at 11; Biller Direct at 19, 37; Jacobs Direct at 13).

43. The Comptroller of the Currency and the FDIC have generally affirmed the recent tendency of banks to get more involved in discount brokerage operations (*see, FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks*, September 1, 1982; *Security Pacific National Bank*, Comptroller of the Currency slip op. at 4-5, August 26, 1982; and *Union Planters National Bank of Memphis*, Comptroller of the Currency Opinion, September 20, 1982).

44. In offering securities transaction services, banks engage in the same activities as brokers. They maintain customer accounts, receive orders from customers, arrange for the execution of those orders or in some instances perform the execution themselves, provide confirmation of the transaction, and keep track of all the records associated with the customer's account (Baxter Direct at 13-14; Baxter Tr. at 433, 491-92; Biller Tr. at 364-65; Jacobs Direct at 9). Banks also employ many of the same securities brokerage procedures that brokers use. For example, in connection with both customer and trust department securities transactions, banks rely on the same

tools as brokers do (*e.g.*, the Quotron, NASDAQ, and other terminals) to select the appropriate market (Grady Direct at 2-4; Ireland Direct at 2-5; Wiatrak Direct at 5; Wiatrak Tr. at 206). In connection with trades involving large orders of both listed and unlisted securities, bank trust departments employ the same techniques for selecting the best market and trading strategies that brokers use (Ireland Direct at 3-5; BAC Exh. 54 at 173-75).

45. Many securities transactions, such as over-the-counter trades, are not conducted on an exchange but with a market maker (Biller Direct at 9; Biller Tr. at 314-15, 360; Jannotta Rebuttal at 4-5, 8-9; Stupski Direct at 2-4). In connection with such transactions off the exchange, banks and brokers execute and clear securities transactions in the same manner (Biller Direct at 12; Biller Tr. at 360-61).

46. While banks have traditionally relied upon brokers to execute listed equity transactions, many brokers, such as "introducing brokers," are not members of exchanges and therefore rely on third parties to execute their transactions involving listed securities, just as banks may do (Biller Direct at 12; Biller Tr. at 239, 243; Evanskass Direct at 1; Drew Direct at 3; Stupski Direct at 3; BAC Exh. 54 at 121-122). Until June 1982, Schwab relied on Pershing & Co. to execute and clear its trades on the New York Stock Exchange, and Schwab still uses Pershing for its options trading (Stupski Direct at 3; Stupski Tr. at 66). Third party correspondent brokers, such as Pershing, offer the same execution and clearing services to both banks and brokerage firms (Stupski Tr. at 110). Pershing is in the business of being a broker's broker and executes transactions as a correspondent broker for over 125 clients, including a number of banks. Fidelity, Schwab's largest discount brokerage competitor, uses Pershing for its NYSE trades (Stupski Direct at 3). Also, brokers that are members of exchanges frequently rely on third parties to execute their transactions just as banks do (Biller Direct at 9; Jannotta Rebuttal at 4-5; Stupski Direct at 3-4; BAC Exhs. 80-83).

47. Banks have traditionally offered margin credit to their customers, pursuant to Regulation U of the Federal Reserve Board. Regulation U, which limits the amounts that banks may lend on stocks, has been in effect since 1936. As of the end of 1981, commercial banks had approximately $5 billion in loans outstanding to purchase or carry securities by borrowers other than brokers, securities dealers or other financial institutions (Baxter Direct at 12). Margin lending by brokers is governed by Regulation T of the Federal Reserve Board. The fundamental activity in broker margin lending—making secured loans to individual customers—is functionally equivalent to bank margin lending, as well as, more generally, the numerous other types of secured lending that banks perform (Baxter Direct at 11-12; Baxter Tr. at 491; Biller Direct at 11, 13; Jacobs Direct at 14; Stupski Direct at 4-5; 12 CFR §§ 220, 221). Margin lending is a major activity for Schwab. Forty-five percent of all trades executed by Schwab are conducted in margin accounts (Stupski Direct at 2-3).

48. Custodial services for securities and other items have traditionally been extensively provided by banks (Ireland Direct at 1; Wiatrak Direct at 5; BAC Exh. 11 at 6; BAC Exh. 53 at 77). Virtually all brokers offer custodial services whereby customers' securities are registered in street name and held in a depository on behalf of the customer. An "introducing broker," which does not itself carry customer accounts or offer custodial services, does so indirectly through its correspondent firm (Biller Direct at 13; Biller Tr. at 319; Jannotta Rebuttal at 4-5, 10-11; Mussa Rebuttal at 12; Stupski Direct at 5; Stupski Tr. at 58; BAC Exh. 79 at ¶ 5; BAC Exh. 80 at ¶ 3; BAC Exh. 81 at ¶ 3; BAC Exh. 82 at ¶ 3, BAC Exh. 83 at ¶ 3). Custodial services are required in connection with margin accounts (Biller Direct at 13; Stupski Direct at 5; Stupski Tr. at 58, 60). Cash account securities certificates may be held by the customer, but approximately 35 percent of Schwab's cash account customers elect to use its custodial services. Taking Schwab's margin and

cash accounts together, approximately 50 percent of all Schwab accounts that are opened involve use of Schwab's custodial services. Securities custodial services are a necessary adjunct to Schwab's brokerage business (Stupski Direct at 5).

49. Many banks offer IRA accounts to their customers (Biller Direct at 13). Some brokerage firms, including Schwab, offer their customers self-directed IRA accounts that allow the customer to contribute annually a set amount of tax-deferred funds, which can be used for different forms of investment (Schwab Direct at 5; Biller Direct at 13; Stupski Direct at 6; Stupski Tr. at 57-58; McLin Direct at 9).

B. *Bank of America's Securities Activities*

50. Bank of American [sic] has historically engaged in a variety of securities transactions services, including trust department services, CTSs and DRPs. In addition, the Bank has been significantly involved in retail transactions with respect to municipal securities, U.S. Government and agency securities, and money market instruments (McLin Tr. at 5-6; Wiatrak Direct at 4-5, 8; Wiatrak Tr. at 189-96, 200-01, 206-08).

51. The Bank's trust department is involved in securities trading for a variety of accounts including agency accounts, personal trusts, court trusts, pension funds (including retirement, stock investment, and profit sharing plans), and the common trust funds managed by the trust department for the investment of assets held by the Bank as trustee. Instructions for trades come either from a district trust administrator (where the power to engage in transactions is held by the maker of the trust or some other person), or from a portfolio manager (where the bank has investment power as trustee) (Ireland Direct at 2).

52. Bank of America's trust department is extensively engaged in securities transactions services. In 1981, the total trust department trading volume for equity securities was approximately $2 billion and for municipal securities was

approximately $151 million (Alcock Direct at 1; Ireland Direct at 2). The total trust department trading volume for fixed income securities during the first half of 1982 was approximately $8 billion (Grady Direct at 4). The Bank's trust assets in 1981 totaled approximately $10 billion for all agency and trust and estate accounts over which the bank had investment discretion (Mussa Tr. at 1005-08).

53. The bulk of the Bank's trust department trading in listed securities utilizes the services of a securities brokerage firm at some stage of the transaction. If buy and sell orders are equal in size and coincide in timing, they may have the opportunity to cross trade and will do so at a price equal to the last sale if the market information available indicates that such a price would be fair. In order to document the price to both trust accounts involved, the bank normally engages a broker to execute the offsetting transactions on an exchange. The brokerage commission involved in such trades is smaller than usual. On occasion the bank has purchased stock directly from the customer-sellers; in such cases establishing the price requires special documentation (Ireland Direct at 3).

54. The Bank provides securities transaction services (CTSs) in which the Bank acts as agent in filling orders for customers (primarily individuals) for the purchase and sale of corporate stocks and bonds. In 1981, the Bank's activity in this connection involved 6,526 trades having a dollar value of $37,512,000. In 1982 (through May) there were 2,508 trades having a dollar value of $10,144,000 (Evenskaas Direct at 1-2).

55. The Bank administers DRPs for BAC and 16 other companies. Six of the plans are original issue plans in which the Bank, acting as agent, purchases stock directly from the issuing company. The rest are market purchase plans. In 1981, DRPs administered by the Bank involved market purchases of 451,808 shares having a total dollar value of $10,689,541 and market sales of 175,894 shares having a total dollar value of $3,690,593 (Drew Direct at 1, 4-5). The Bank utilizes a broker in connection with these activities (Drew Direct at 3).

56. In 1981 the Bank engaged in 29,993 transactions in municipal securities, reflecting a total dollar value of $25 billion, an average of $800,000 per trade (Wiatrak Direct at 2; Wiatrak Tr. at 195-198). In 1981 the Bank had 52,103 trades in U.S. Government and U.S. agency securities reflecting a total dollar volume of over $130 billion (Wiatrak Direct at 6). Most of the business involving municipal securities, U.S. Government and agency securities, and money market instruments is institutional; however, the Bank is also significantly involved in retail transactions with respect to such securities. BAC employs 35-40 employees for retail activities involving these securities and actively solicits individual customers for municipal securities (Wiatrak Tr. at 190-91, 206-07). Between 50 to 60 percent of the Bank's total number of transactions in municipal securities involve individuals (Wiatrak Tr. at 207), and 10 to 15 percent of the dollar volume of trades of municipal securities, U.S. Government and agency securities, and bankers' acceptances are retail transactions (Wiatrak Tr. at 190, 194, 196). Applying these percentages to the Bank's total annual volume of sales in municipal securities, U.S. Government and agency securities, and bankers' acceptances, the Bank's annual volume of sales to individuals in these securities is approximately $3 billion, $16 billion, and $1.4 billion, respectively (Wiatrak Direct at 2, 6, 8-9; Wiatrak Tr. at 200-01).

C. *Other Financial Activities By Banks And Brokers*

57. During recent years as the impact of inflation has increased the cost of having idle funds that do not earn a return and consumers have become increasingly sensitive to the cost of leaving funds underutilized, brokerage firms have begun to make available to these customers a return on the cash balances in the customers' accounts (Biller Direct at 14-16; Stupski Direct at 6-7; Stupski Tr. at 115-18). Virtually all brokers of any significant size offer their customers some mechanism through which they can earn a return on the available funds in their accounts pending further investment

(Biller Direct at 14-17; Biller Tr. at 319-20; Stupski Direct at 6-13; BAC Exh. 79 at ¶ 8-9; BAC Exh. 80 at ¶ 7; BAC Exh. 81 at ¶ 7; BAC Exh. 82 at ¶ 7; BAC Exh. 83 at ¶ 7).[5] The provision of means for customers to earn a return has become a virtual necessity for effective competition in the brokerage business on any significant scale (Stupski Direct at 6-7; Stupski Tr. at 101-02, 115-18; *see also* Biller Direct at 14-17; Biller Tr. at 369; Mussa Tr. at 1012; BAC Exh. 79 at ¶ 8-9; BAC Exh. 80 at ¶ 7; BAC Exh. 81 at ¶ 7; BAC Exh. 82 at ¶ 7; BAC Exh. 83 at ¶ 7). The provision of an opportunity to earn a return on available funds through an account arrangement is comparable to certain aspects of banking.

58. One method by which many brokerage firms, as well as banks and savings and loan associations, provide for a return on funds in customer' [sic] accounts is through "sweep accounts." Sweep accounts are money market funds that link existing security brokerage accounts and/or bank accounts to productive investments. Essentially, amounts above a specified minimum are regularly "swept" out of a customer's account with a bank or brokerage firm and into a money market fund, where it earns a higher rate of return. At present a number of brokers and depository institutions offer retail "sweeps" in conjunction with independent money market fund management companies, such as Fidelity, Federated, Kemper, or Dreyfus. Banks offering such "sweep" accounts include Chase and Bank of New York. Federated now claims to be offering this service to more than one hundred banks (Biller Direct at 15-20; Jacobs Tr. at 548, 563-64; Stupski Direct at 8-9; Biller Tr. at 319-20).

59. In addition to offering "sweep" arrangements, some brokers, including Schwab, also pay interest directly on tem-

5 As of March 18, 1981, thirty-four money market mutual funds operated by brokers or dealers accounted for 60% of the $104.5 billion in assets of 110 such funds. (Reported in *Donoghue's Money Fund Report*, and cited in the SEC's staff report on "The Securities Industry in 1980" at 79).

porarily idle funds in their customers' accounts (Stupski Direct at 9-10; BAC Exh. 81 at ¶ 3; *Security Pacific National Bank*, Comptroller of the Currency slip op. at 16, August 26, 1982). The direct payment of interest on customer cash balances by brokerage firms by definition and practice is functionally equivalent to the payment of interest by banks on accounts such as savings acounts (BAC Exh. 11 at 65).

60. Cash management accounts are another means by which brokerage firms service their customers. It is a hybrid account, offering a number of financial services. Its main features usually include (1) the opportunity to earn interest on net free balances in a brokerage account, through either a money market fund functioning as a "sweep" account or the direct payment of interest, (2) a mechanism by which the customer can more readily redeem his funds, whether by check or by debit card, (3) the use of margin accounts to secure borrowing against eligible securities, (4) automatic features that tend to maximize returns received, through the establishment of a hierarchy of investments and redemptions (such that withdrawals are made from the least remunerative funds and investments are made to the highest yield funds), and (5) integrated monthly statements showing all account activity and balances (Biller Direct at 15-16).

61. Banks have been participants in the provision of cash management accounts since their initiation. Crocker Bank of San Francisco has its Working Capital Accounts and Citibank of New York has a similar program. Bank One of Columbus, Ohio, serves Merrill Lynch, Dean Witter, and Bache (Biller Direct at 17-18). Brokerage firms, including Schwab through its Schwab One Account, offer their customers cash management accounts. Providers of such accounts include Merrill Lynch (Cash Management Account), and Bache Halsey Stuart (Command Account). (Biller Direct at 15-20; Biller Tr. at 248-51, 319-20; Stupski Direct at 10-12; Stupski Tr. at 76; BAC Exh. 79 at ¶¶ 8-9; BAC Exh. 80 at ¶ 7; BAC Exh. 81 at ¶ 7; BAC Exh. 82 at ¶ 7; BAC Exh. 83 at ¶ 7).

62. The Schwab One Account arrangement was introduced in November 1981. It offers a variety of financial services, including the maintenance of an account at Schwab for securities transactions, the payment by Schwab of interest on net free balances, check-writing privileges, a VISA debit card with a one-percent discount for purchases, and a comprehensive monthly statement of all activity in the account (Stupski Direct at 10-11 [Stupski Exh. 6]; Stupski Tr. at 76-83). The interest rate offered by Schwab, which currently is based on the 13-week Treasury bill rate, is lower than the rates that could be obtained through various other interest-earning investment opportunities, such as money market funds (Stupski Direct at 11; Stupski Tr. at 79).

63. The treatment of free credit balances in a customer's account is governed by a number of applicable regulations. New York Stock Exchange Rule 436, SEC Release 34-18262 (1981), as well as the Securities Investors Protection Act, strictly limit the manner in which interest-bearing accounts may be offered and maintained. Rule 15c 3-3 under the Securities Exchange Act of 1934 limits the uses to which customer balances can be put (Stupski Tr. at 81). Schwab has recently adopted a policy of sending a written reminder every six months to all account holders who have not conducted any trades in the previous six months, informing them that they should only keep in their Schwab One Account funds that are "awaiting investment" (Stupski Direct at 11; Stupski Tr. at 80-83).

D. *Schwab's Inadvertent Principal Transactions, Munimart Service, and Money Market Fund Activity*

64. "Inadvertent principal" transactions occur when Schwab makes a mistake in purchasing securities on behalf of a customer and must maintain (and then liquidate) the unwanted shares for its own account. Principal positions that arise as a result of errors are an unavoidable incident to the ordinary conduct of any agency securities transaction business and

typically create a loss (Stupski Direct at 13-14). Inadvertent principal positions arise in well below 1 percent of all of Schwab's trades, and therefore constitute a miniscule portion of Schwab's business (Stupski Direct at 14).

65. Schwab's Munimart service, which Schwab introduced in July 1982, offers customers the opportunity to purchase and sell municipal bonds through Schwab. It involves two types of transactions: (1) secondary market transactions in which Schwab arranges for the purchase and sale of municipal bonds that have already been issued, and (2) new issue transactions in which Schwab arranges for the purchase of new municipal bond offerings (Stupski Direct at 15). In secondary market transactions, Schwab acts as agent for its customers in the same way it now does in transactions involving unlisted (over-the-counter) securities—*i.e.*, securities that are not traded on an exchange. In such transactions, the broker must seek out the dealer selling (or purchasing) the securities covered by the customer's order (Stupski Direct at 15-16; Stupski Tr. at 123-24). In transactions involving new municipal bond issues, Schwab purchases the municipal securities from the underwriting syndicate offering the bonds, but only if it has a firm customer purchase order for that security on hand prior to its acquisition of the bond. It then immediately resells the bonds to its customer at the public offer price (Mussa Direct at 42; Stupski Direct at 16-18). Schwab's revenues from its Munimart service, including both secondary market transactions and new issue transactions, constitute less than 0.2 percent of its entire revenues. Most of these transactions involve the secondary market. In the first month and a half after the Munimart service began operations, Schwab only engaged in two new issue transactions (Stupski Direct at 18; Stupski Tr. at 95).

66. Schwab offers a "sweep" arrangement in conjunction with the Kemper Cash Equivalent Fund (the "Fund"), a money market fund that is advised and administered by Kemper Financial Services, Inc. ("Kemper") (Stupski Direct at 7). Schwab acts only as an agent for its customers in dealing with

the Fund. It arranges for the purchase of shares in the Fund on behalf of the customers, processes the transfer of payments between the Fund and the customers' accounts, and generates periodic records for its customers reflecting their investment in the Fund. Schwab does not purchase shares in the Fund for its own account for resale to its customers. Schwab receives no remuneration from its customers for these services it performs. The Fund maintains on its books the names of the Schwab customers holding an investment with the Fund and transmits all proxy materials directly to them (Stupski Direct at 7-8). Under its agreement with Kemper, Schwab receives compensation from Kemper calculated on a sliding scale ranging from 35 basis points to 25 basis points *per annum* of different amounts in the Fund. Schwab is compensated for its *pro rata* share of the entire amount in the Fund, based on the shares its customers hold in the Fund pursuant to Schwab's agreement with Kemper. For the fiscal year ending September 30, 1981, Schwab's payments from Kemper constituted less than 1 percent of Schwab's revenues (Stupski Direct at 9; Stupski Rebuttal at 3-4).

IV. *Public Benefits Resulting From the Acquisition*

A. *Increased Awareness of Discount Brokerage Firms Will Lead to Lower Costs for Consumers*

67. Between April of 1975, the last month before the unfixing of brokerage commission rates, and December 1981, institutional commission rates (cents per share) decreased by 66.5%; rates for individual investors decreased by only 33.3%. Commission rates as a percent of principal value declined 57.1% for institutions and 22.07% for individuals. The decline in rates charged individuals was due to reductions in charges for large orders and an increased percentage of large orders. In 1981 individual investors experienced an overall decline in commission rates with respect to large and small orders. However, commissions charged individuals for small order transactions involving fewer than 1000 shares are presently

greater on a per share basis than under the fixed rates (BAC Exh. 52 at 2, 6-10 [SEC Report on "Commission Rate Trends 1975-1981"]).

68. There are two basic types of brokerage firms, generally referred to as full-line brokers and discount brokers (SIA Exhs. 7, 10; Biller Tr. at 253-255). "Full-line" brokerage firms are firms that typically offer the widest range of customer services (solicitation of orders and investment research and advice) and, generally, charge a single price covering both execution and advice. "Discount" brokers are brokers who charge commissions below prevailing rates. Discount brokers tend to offer fewer services and to emphasize price and execution. They often do not offer investment advice (Baxter Direct at 26; Baxter Tr. at 437-38; Biller Direct at 23; Biller Tr. 254-255, 335; Stupski Tr. at 61-63; BAC Exhs. 79-83). Discount brokerage firms in general and Schwab in particular have commission rates that are generally below those offered by brokerage firms prior to May of 1975. Discount brokerage firms also have commission rates that are below the rates charged by full-line brokerage firms (BAC Application at 8; BAC-Biller Exh. 13 [Discount Brokerage Firm Advertisements]). There are a number of discount brokerage firms that charge commissions [sic] rates that are lower than Schwab's (Mendelson Rebuttal at 6; Stupski Tr. at 61-62; SIA Exh. 40). As of the fourth quarter of 1980, discount brokerage firms' commission revenues constituted only 6.1% of total commission revenues received by all brokers (BAC Exh. 55 at 102 [SEC Staff Report "The Securities Industry" 1980]; *see* F. 30).

69. Full-line firms do give discounts to some of their customers, but they normally decline to disclose their policies on discounts or even the normal commission rates they charge (Biller Direct at 28; Biller Tr. at 323, 356; Jacobs Direct at 21-22; Jacobs Tr. at 552-53, 554j-54k; Stupski Tr. at 104; BAC Exh. 32 at 29; BAC Exh. 80 at ¶ 6; BAC Exh. 81 at ¶ 6; BAC Exh. 82 at ¶ 6; BAC 83 Exh. at ¶ 6; *see* F. 27). Institutional

customers, such as banks and insurance companies, are large and significant customers of brokerage services. They could and did ask for and receive competitive price quotations. After May 1, 1975, when fixed commissions were eliminated for retail brokerage business, the then-existing full-line firms generally did not lower their commission rates on retail business, and they have continued to compete almost exclusively on the basis of service. (Biller Direct at 22, 27-28; Ireland Direct at 3; BAC Exh. 39 at 17-18; BAC Exh. 55 at 98; BAC Exh. 74 at 361, 424-25; BAC Exh. 52 at 2, 6-10 [SEC Report on "Commission Trend Rates 1975-1981"]).

70. A wide variety of publications and investment advisory services are available at reasonable costs to investors who choose not to rely on full-line brokers for advice or investment research (Biller Direct at 22; Schwab Direct at 6). Customers of full-line firms who trade on the basis of their own research or research obtained from sources other than their broker, and customers who use full-line brokers for unsolicited orders, could in general use discount brokers to achieve identical services and pay lower commission rates (Biller Direct at 22, 26; Schwab Direct at 6-7). Discount brokerage firms are presently in direct competition with full-line brokers for some of these customers, as evidenced by discount brokerage advertisements which compare full-line prices and discount prices (BAC Biller Exh. 13 [Advertisements of Discount Brokerage Firms]). There is evidence that there is a substantial overlap between the customers of discount brokerage firms and full-line brokerage firms (SIA Proposed Finding 94).

71. According to the testimony of BAC witnesses, many potential customers of discount brokers do not yet use such brokers because discounters are relatively new and not well-established in the marketplace (Biller Direct at 30-31; Biller Tr. at 327-28; Jacobs Direct at 19-20; Jacobs Tr. at 569-70; McLin Direct at 10; Mussa Tr. at 927; Schwab Direct at 7-8; Stupski Tr. at 104; *see also* F. 30). There also is some evidence in the

record that the public distrusts discount brokerage firms (BAC Biller Exh. 14, *Confidential*). Affiliation with BAC would associate Schwab with a well-known and reputable financial organization and would make Schwab more visible to potential customers (SIA Brief at 83-84).

72. Full-line brokerage firms take the activities of discount brokers into account in determining their prices and how they will compete. By making Schwab a more effective competitor, the acquisition will tend to elicit competitive responses from other brokers, including both full-line firms and discount brokers (Baxter Direct at 19; Baxter Tr. at 483; Biller Direct at 32, 34-35; Jacobs Direct at 22; BAC Exhs. 79-83). In response to increased and more effective competition from Schwab and other discount brokers, full-line firms would be more likely to compete on the basis of price and to "unbundle" their services (*i.e.*, allow brokerage customers to purchase execution services separately from advice). Insofar as full-line brokers respond to additional competition by unbundling their services or more vigorously competing on the basis of price, investors will benefit by being able to choose from among a greater number of suppliers of a wider variety of packages of services, and from increased price competition (Schwab Direct at 9; Baxter Tr. at 439-40, 454-459, 460, 483; Baxter Direct at 15-18; Biller Direct at 27-28, 30-37; Biller Tr. at 374; Jacobs Direct at 17-23; Jacobs Tr. at 549-51; Mussa Tr. at 895-96; BAC Exh. 74; BAC Exh. 32 at 32).

73. BAC's acquisition of Schwab will help make Schwab a more effective competitor by providing Schwab with capital for office expansion, technical innovation, and other purposes, and by providing Schwab with additional management and technological resources (Baxter Direct at 18-20; Biller Direct at 29-34; Biller Tr. at 371-72; Jacobs Direct at 18-22, 27-29; Jacobs Tr. at 554-54h, 565-66; McLin Direct at 10-11; McLin Tr. at 19; Mussa Rebuttal at 21, 27-28; Prussia Direct at 8-9; Schwab Direct at 6-8; Stupski Tr. at 72; Wiatrak Tr. at 214).

Schwab's past innovations include creation of an "on line" system of customer accounts (which reduces paperwork and allows the registered representative to confirm securities trades by computer), and extensive use of automated execution services offered by various exchanges (Schwab Direct at 10-13; Biller Direct at 29). Capital assistance from BAC will help Schwab remain a leader in embracing new technologies that enable brokers to cut costs, reduce error rates, and provide better service (Baxter Tr. at 460-61; Biller Direct at 29-34; Jacobs Direct at 27-29; Jacobs Tr. at 554d-54g; McLin Direct at 11; Prussia Direct at 8; Schwab Direct at 10-13; Stupski Tr. at 72). Insofar as the acquisition enhances Schwab's development and use of new technologies, these will increase competition in the securities brokerage business and will help to spread such new technologies throughout the industry (Biller Direct at 32-35; Jacobs Direct at 27-29; Schwab Direct at 12-13).

74. Competition among all financial institutions has increased and has focused on providing consumers with attractive packages of financial services that cut across traditional industry lines (Biller Direct at 14-20; Jacobs Direct at 26-27; Jacobs Tr. at 544-45; McLin Tr. at 9-10; Prussia Direct at 4-5; *see also* Findings 57-63). Many brokerage firms are now offering packages of financial services to their customers, including asset management accounts that combine traditional brokerage accounts, margin lending, check writing privileges, use of a credit or debit card, and "sweep" or other transaction features that help to assure that maximum rates of return are earned on free cash balances. These packages of financial services are competitive with services offered by banks (Biller Direct at 14-20; Jacobs Direct at 15-16; 26-27; BAC Exh. 51; *see also* Findings 57-63). Since BAC's announcement of its planned acquisition of Schwab, numerous banks have announced plans to provide discount brokerage services either directly or through joint venture programs (Baxter Direct at 11; Baxter Tr. at 463-65; McLin Direct at 7; *see also* F. 43). BAC's development of financial service offerings with Schwab

will spur competition between banks and between banks and other financial service firms to provide attractive packages of financial services (Biller Direct at 32-35; Biller Tr. 320-21; McLin Direct at 11; Prussia Direct at 7-8; Jacobs Direct at 22-23; Jacobs Tr. at 544-48). By allowing BAC to compete more vigorously in the emerging "financial services" industry, the acquisition will result in increased competition among all financial services firms (Baxter Direct at 19; Baxter Tr. at 463-66, 481; Biller Tr. at 320; Jacobs Direct at 22-23, 26-27; McLin Direct at 2-3, 6; Prussia Direct at 3-5, 7, 10-11).

B. *Increased Convenience*

75. The acquisition will provide Bank customers with convenient brokerage services and Schwab customers with convenient banking services (Baxter Tr. at 460-62; Jacobs Tr. at 553; McLin Direct at 8; McLin Tr. at 36; Prussia Direct at 7; Wiatrak Tr. at 214). The acquisition will enable Schwab to make its services conveniently available through Bank offices in California (and potentially through FinanceAmerica offices outside the state) (Baxter Direct at 21; Baxter Tr. at 433; Biller Direct at 31-32; Biller Tr. at 339-40; McLin Tr. at 19, 34-36). Bank already has instituted a test program to provide access to Schwab's services (including account forms, a quotation machine, and a certificate depository) by means of kiosks in several Bank branches (Biller Tr. at 370-71; Jacobs Tr. at 554; McLin Direct at 8-9; McLin Rebuttal at 1-5; McLin Tr. at 15-17, 30, 36-37). BAC has anticipated that it will add several thousand new Bank customers from Schwab customers through cross selling of services (*see* F. 103).

C. *Increased Efficiencies*

76. The potential for "complementary" and/or increased efficiencies exists with respect to banking and brokerage services (Baxter Direct at 17-18; Baxter Tr. at 433-34; Becker Rebuttal at 7-10; Wiatrak Tr. at 214). The acquisition will allow BAC and Schwab to share management resources

(Jacobs Direct at 19-21; McLin Direct at 11). It will allow BAC and Schwab to share marketing resources (Baxter Direct at 19; Biller Direct at 31-32; Jacobs Direct at 19-20; McLin Tr. at 34, 40), and computer resources (Biller Direct at 33-35; McLin Tr. at 19, 35). The acquisition will allow Schwab to increase the efficiency with which it obtains capital funds, since BAC will more readily be able to ascertain Schwab's needs, and the appropriate cost of funds, than could unaffiliated providers of funds (Becker Rebuttal at 4; Mussa Tr. at 788). Insofar as potential customers select Schwab or BAC services on grounds of convenience, this will result in increased efficiencies because fewer resources will be used to produce the same goods (Baxter Rebuttal at 1-2; Becker Rebuttal at 7-8).

77. BAC's acquisition of Schwab will be more efficient than expansion of the Bank's existing activities since the latter would require the accumulation of new management resources and computer software, and substantial time (Baxter Tr. at 480-81; McLin Direct at 5; McLin Tr. at 7-9, 11, 13-14; Prussia Direct at 6). BAC's acquisition of Schwab will make it possible for Schwab to compete more effectively immediately and will avoid substantial delay in the time in which increased competitive pressures can be brought to bear upon full-line brokers in the retail brokerage market (Baxter Tr. at 479-81; Jacobs Direct at 425; McLin Tr. at 9, 11). BAC's acquisition of Schwab will be a more efficient way for it to expand in the retail brokerage industry than by joint venture since the BAC/Schwab product development can be permanent and tailored to new offerings BAC believes will be most attractive and not limited to accepting the services offered by individual joint venture contractors (Baxter Tr. at 466; McLin Direct at 6; Mussa Tr. at 722).

D. *Increased Financial Support*

78. The acquisition will allow Schwab to increase the amount of capital funds available for growth and investment in new technology since BAC will be able to supply the firm with money at a lower marginal rate than Schwab would

obtain on its own (Mussa Direct 6-7, 11-18). In 1980, Schwab had to abandon an attempt to access the capital market because of a lack of public response (BAC Application at 31).

79. The securities brokerage industry's earnings are volatile due to relatively high fixed costs and widely fluctuating earnings caused by wide variations in trading volumes (Mendelson Direct at 11-14; Mendelson Rebuttal at 8-9). BAC's capital resources will be able to provide Schwab with more financial stability during times of stress (*see* SIA Proposed Findings 365-367, 369-370).

E. *Synergistic Effect of the Acquisition*

80. Affiliation with BAC will give Schwab access to broader management and technical resources. BAC has experience in many areas as yet untouched by Schwab. For example, BAC has large-scale foreign operations, an arena of great growth potential that Schwab has recently entered by opening a Hong Kong office (Prussia Direct at 9; Baxter Direct at 21). Schwab will also be able to draw on BAC's advanced technical skills in the area of data processing (Schwab Direct at 12-13).

81. BAC and Schwab both have excess data processing capacities. Due to the fact that they have different demand cycles for computer time, by joint utilization of facilities the firms can reduce excess capacity making more efficient use of a single combined system (McLin Tr. at 19, 35; Biller Direct at 33-35).

V. *Possible Adverse Effects of the Acquisition*

A. *Schwab's Competition in the Municipal Bond Market*

82. The Bank serves as an underwriter of certain general obligation municipal bonds, and it maintains a trading inventory of $135 million of such securities which are bought or sold from time to time in large block transactions. The Bank is the predominant bank underwriter and dealer in municipal bonds

in California (Mussa Tr. 921). Municipal bonds are not traded on exchanges and must be purchased (or sold) through dealers who carry such bonds (Stupski Rebuttal at 2).

83. Under the Munimart arrangement, developed after the announcement of BAC's proposed acquisition of Schwab, Schwab carries out orders for municipal bonds for its customers by obtaining a quote from the Bank on the desired bond or a similar bond in the Bank's inventory. If the Bank does not possess the precise bond requested by Schwab's customer, then the Bank will offer quotes on similar bonds in its inventory, which quote the Schwab employee will pass on to the customer. If the customer agrees to make the purchase after learning of the bond's availability, Schwab will buy the bond from the Bank's bond department for immediate resale to the customer (SIA Exh. 17 at 2; Mussa Direct at 41-42). In only about half the bond transactions it carries out do Schwab customers specify the particular bond desired (Stupski Tr. 122-23).

84. The Munimart arrangement between BAC and Schwab presents an opportunity for the Bank to sell some municipal securities to Schwab customers that it might not otherwise sell through its underwritings (Mussa Direct at 44). Since the inception of the Munimart arrangement, approximately 80% of Schwab's municipal bond transactions have been conducted through the Bank; in about 50% of the transactions the bank acts out of its own inventory, and in the remaining 30% the bank acts as an agent finding a buyer to purchase a bond Schwab's customer is selling (Stupski Rebuttal at 4).

85. Banks have a special tax privilege allowing them to deduct the entire carrying costs for their inventories of municipal bonds in determining their federal tax liabilities (Mussa Direct at 42; Wiatrak Tr. 231; Mussa Tr. 1013). The Internatl [sic] Revenue Service does not permit broker-dealers who hold inventories of tax-exempt municipal bonds to deduct interest paid on that fraction of their debt that is assigned to the

carrying of municipal bonds (Mussa Tr. at 1013). Therefore, commercial banks that operate as traders of municipal bonds have a significant tax advantage relative to securities dealers that trade the securities (Mussa Direct at 43). The Bank would realize this tax advantage on the bonds out of innventory [sic] which are sold through the Munimart arrangement with Schwab.

86. Bank holds in inventory municipal bonds which it sells to other brokers and dealers at the same price at which it sells to Schwab. The Bank and other dealer banks and broker/dealers advertise in the blue list the bonds in their inventory which they wish to sell through the same, nationwide medium (Darby Rebuttal at 1; Stupski Tr. at 85-86; Mussa Tr. at 849-51). Other brokerage firms are able to carry out buy and sell orders for municipal bonds from their customers in conjunction with commercial banks (Becker Rebuttal at 11). In such case there is no reason to believe that Schwab will receive any artificial advantage as compared to other firms that buy municipal bonds from the inventories of the Bank, dealer banks, and broker/dealers (Becker Rebuttal at 11-12).

B. *Capital Costs for Bank Subsidiaries*

87. It is a common practice for parent companies to provide money to their subsidiaries in the form of equity capital and loans in order to meet the funding requirements of the subsidiaries (Mussa Tr. at 942; Biller Tr. at 342-45; S. Rep. No. 1095, 84th Cong., 1st Sess. 15 (1955)). An acquired company which is funded by its parent may experience lower funding costs after the acquisition for several reasons, including the strengthening of the subsidiaries' economic potential and lessening of its risk as part of a larger enterprise, and on account of efficiencies with respect to transaction costs and evaluation of the risks which the subsidiary faces (Becker Rebuttal at 2-4; Mussa Tr. at 786-88, 946; Prussia Direct at 8-9).

88. Commercial banks and other depository institutions enjoy advantages over other types of firms in their costs of

securing capital when such funds are obtained from depositors (Mussa Direct at 6-7). Federal deposit insurance agencies provide an absolute guarantee against losses by depositors in insured institutuions [sic] for deposits up to $100,000 (Mussa Direct at 5; Mussa Tr. 780-81). Government agencies such as the federal Rrserve [sic] banks provide protection to holders of large uninsured deposits by loaning money to commercial banks to enable such depositors to withdraw their deposits when a bank is experiencing financial difficulty (Mussa Direct at 5). The commercial bank advantage in obtaining these funds is attributable to government-provided explicit and implicit guarantees that deposits will be insulated wholly or partially from losses (Mussa Direct at 6; Mussa Tr. 978).

89. Banking laws restrict lending by a bank to its parent holding company and to that holding company's non-banking subsidiaries so severely as to make such lending impracticable. Thus, BAC, not the Bank, is the source of funding for its non-banking subsidiaries (Prussia Direct at 10). BAC will be able to provide capital to Schwab in a manner more efficient and at lower cost than the alternatives available to Schwab were it to enter the capital markets directly (Prussia Direct at 8; Mussa Direct at 12-14).

90. Under the policies in force with respect to funding by BAC of its wholly-owned non-bank subsidiaries, a non-bank subsidiary must identify the uses to which borrowed funds are put and on that basis the rate charged is either the long-term rate or the short-term rate. The short-term rate is a compilation of the monthly average yields on 90-day commercial paper of ten A-1, P-1 rated companies, to which is added 0.125 percent per annum for handling and 0.138 percent per annum to cover the cost to BAC of the commitment fees on its standby lines of credit. The resulting rate closely reflects the actual cost of short-term funds to BAC, which obtains such short-term funds principally through the issue of commercial paper (Terry Direct at 2; SIA Exh. 6). A1 is the top rating for

commercial paper by Moody's; P1 is the top rating for commercial paper by Standard and Poor's (Mussa Tr. 948).

91. A more complex market rate is used by BAC to charge non-bank subsidiaries for long-term funds. That market rate reflects the fact that long-term funds are raised over time, at varying intervals and at varying interest rates. Each month the average yield on secondary market one-year certificates of deposit issued by prime banks is taken from available market information sources. The resulting rate is adjusted for the additional cost of reserves and federal deposit insurance and for differences in the frequency of the payment of interest. Because the market for CDs with maturities in excess of one year does not have sufficient depth to give consistent, reliable market rates relevant to the Bank's and BAC's cost of longer-term funds, a maturity premium or discount is added, based on the differences in yields on one-year and five-year U.S. Treasury obligations. This rate closely reflects the cost of acquiring five-year funds by the Bank and by BAC during the relevant month. For the actual interest charges for long-term funds, it is assumed that the funds supplied by BAC and used by the subsidiary were acquired in equal monthly amounts over the preceding 60 months and a "composite" or "pool" rate for such funds is then calculated (Terry Direct at 3-4).

92. The charges to BAC's subsidiaries are designed to and do reasonably approximate BAC's own cost of funds (Terry Direct at 2-4). BAC would have no incentive to provide funds to Schwab unless it could expect to receive a return equal to the marginal cost to it of making these funds available, including an appropriate return for the risk incurred (Becker Rebuttal at 3-4, 12; McLin Tr. at 24-26; Prussia Direct at 8).

93. The equity capital of the Bank dominates the financial statements of its holding company (Mussa Direct at 7; *see also* F. 3); therefore, the cost of capital to BAC is largely determined by creditors' assessments of the risks of the Bank (Mussa Direct at 7-8; Mussa Tr. at 776, 980-81). Those who control institutions which have lendable funds are aware that

government agencies will not allow a large commercial bank to fail. Hence, those institutions are willing to lend funds to large commercial banks on more attractive terms than they would be willing to lend to other types of businesses (Mussa Direct at 5-7). However, bank holding companies in general do not raise money at lower rates than other large firms. In fact, bank holding companies incur somewhat higher marginal costs for short, medium, and long-term funds as compared to large industrial and non-bank related financial firms (Kimmell Rebuttal at 4).

94. The testimony and affidavits of officials of BAC, Merrill Lynch and Bache Halsey Stuart (a brokerage subsidiary of Prudential), show that the commercial paper rates of BAC were, if anything, slightly higher than the commercial paper rates of Merrill Lynch, Sears, and Prudential for the period May through July of 1982 (Cush Rebuttal at 2 [Cush Exh. 1]; BAC Exh. 84 [Merrill Lynch letters]; BAC Exh. 85 [Bache letter]). Statistics published by the Federal Reserve Board indicate that BAC's commercial paper rates during the period May through July 1982 were generally the same or higher than both the rates on commercial paper placed for other firms whose bond rating is AA or the equivalent and the rates on commercial paper of firms which placed their commercial paper directly (*Compare* Federal Reserve Statistical Release Forms H.15 (519) for May through July 1982 *with* Cush Exh. 1). Similarly, the Forms 10-K of Merrill Lynch and American Expreess [sic] and the Annual Report of Sears show that the weighted average interest cost of their commercial paper in 1979, 1980, and 1981 were comparable to the cost experienced by BAC:

	1979	*1980*	*1981*
Sears	11.03	13.05	16.36
Merrill Lynch	11.01	13.30	16.21
American Express	11.06	13.16	15.88
BAC	11.27	12.58	16.34

BAC Exh. 1 at 30-31; BAC Exh. 61, 62; BAC Exh. 63 at S-9.

C. *Effect of Acquisition of Schwab on BAC's Banking Position in California*

95. There are 308 banks in California, thirteen have resources in excess of $1 billion and five have resources in excess of $10 billion (Mussa Tr. at 740). Bank of America is the largest bank in California; it had domestic deposits of $51,944 million in 1981, or 35.8% of all bank deposits in the State of California (SIA Exh. 37 at 111; Mussa Direct at 47-48; Mussa Rebuttal at 30, 41; F. 5). The bank's largest competitors in the California banking market are Security Pacific, Wells Fargo, Crocker National, and First Interstate (Mussa Tr. 740). As of 1981, Security Pacific has 12.3% of California bank deposits state-wide ($17,917 million), Wells Fargo had 9.8% ($14,200 million), Crocker National had 8.3% ($12,065.7 million) and First Interstate had 7.6% ($11,036.6 million) (SIA Exh. 37 at 111). As of December 31, 1981, the five largest California banks accounted for over 74% of all domestic deposits (4-firm concentration = 66%) and 76% of all domestic loans (4-firm concentration = 68%) in California banks (SIA Exh. 37; Mussa Rebuttal at 30-31).

96. Recent developments in financial services have significantly eroded the uniqueness of the products that commercial banks can offer so that banking concentration does not fully reflect the alternative sources available to the public for all the different banking services in a local market. The inclusion of non-bank depository institutions (savings banks and savings and loan associations) and other types of financial institutions, including those outside California but competing in the state, would dilute the market power of local commercial banks (Schweitzer Rebuttal at 5). When California savings and loan association deposits are added to bank deposits, the Bank's share of total deposits becomes 20.2% (Mussa Rebuttal at 32).

97. A number of separate and distinct products and services are offered by commercial banks. These include, *inter alia,* demand, time, and savings deposits; mortgage loans; consumer

loans; and business loans (Mussa Tr. at 614-22). In offering each of these financial services, California commercial banks compete to some extent not only with other California commercial banks, but also with out-of-state commercial banks, with foreign banks, and with many nonbank financial institutions (Baxter Tr. at 443-51). For example, in offering deposit services, California commercial banks compete with savings and loan associations and credit unions in California and with money market funds available nationwide (Baxter Tr. at 443-46; Mussa Tr. at 615, 622; BAC Exh. 71). In making mortgage loans, California commercial banks compete with savings and loan associations, mortgage bankers, insurance companies, and a variety of other lenders located both inside and outside of California (Mussa Tr. at 619, 907-08, 910-11; BAC Exh. 71). In making consumer loans, California commercial banks compete with savings and loan associations, finance companies, credit unions, retail merchants, and a variety of other lenders in California, as well as with banks and other institutions located outside of California (Baxter Direct at 23-24; Baxter Tr. at 477; Mussa Tr. at 620-21; BAC Exh. 71). In making business loans, California commercial banks compete with out-of-state bank loan production offices, savings and loan associations, finance companies, insurance companies, money market funds and other institutional purchasers of commercial paper, and a variety of other lenders (Baxter Direct at 23-24; Mussa Tr. at 615-22, 908-14). The majority of competition in national and international markets is for corporate business, [sic] the retail business is primarily a locally limited business (Baxter Tr. at 447).

98. According to a consumer survey prepared for Bank of America, the Bank's share of all loans to California consumers is approximately 9%. This study reflects loans and deposits by credit unions, finance companies, and other financial institutions in addition to banks and savings and loan associations (BAC Exh. 71). The Bank's share of all California consumer deposits held by banks, savings and loan associations, credit

unions, and other financial institutions is approximately 16 percent (BAC Exh. 71).

99. The Herfindahl Index is a measure of concentration used by economists for evaluating the competitive structure of a market. The Herfindahl Index for any market is the sum of the squares of the market share of all of the firms in that market. (The Index for a market with 100 equal size firms, each with a market share of 1 percent, would be 100. The Index for a market with a single firm with a 100 percent market shares would be 10,000.)

100. The Herfindahl index for bank deposits by Standard Metropolitan Statistical Areas ("SMSAs") in California range from 1400 to 2070 (Mussa Tr. 624-25, 1018), and the Index for bank deposits state-wide is 1680, (SIA Exh. 63; Mussa Tr. 624-25, 1017-18).

101. The following chart, which is set forth in the record as SIA Exhibit 62 (*see also* Mussa Tr. 1015-1019), indicates the Bank's share of deposits, and the Herfindahl index for bank deposits in California by SMSA. This data was calculated from FDIC data submitted by BAC (BAC Exh. 72) and from data collected by the Bank (SIA Exh. 37).

SMSA Code	*SMSA Name*	*Total Deposits (millions)*	*B of A Share*	*HI(1)*
0360	Anaheim	8,313	23.5	990
0680	Bakersfield	1,529	42.2	2310
1620	Chico	577	45.3	2610
2840	Fresno	2,086	47.7	2620
4480	Los Angeles(2)	46,593	24.7	1430
5170	Modesto	1,174	26.6	1400
6000	Ventura	1,586	30.5	1750
6690	Redding	442	43.3	2430
6780	Riverside San Bernadino	4,616	33.8	2270
6920	Sacramento	4,357	37.5	2090

SMSA Code	SMSA Name	Total Deposits (millions)	B of A Share	HI(1)
7120	Monterey Salinas	1,082	32.9	2410
7320	San Diego	6,444	28.6	1410
7360	San Francisco(2) Bay Area	44,078	51.0	3020
7400	San Jose	5,517	34.4	1830
7480	Santa Barbara	1,318	23.5	1380
7485	Santa Cruz	813	26.0	2740
7500	Santa Rosa	1,273	34.5	2060
8120	Stockton	1,819	31.3	1790
8720	Napa-Fairfield	1,101	45.8	2580
8780	Tolare	853	37.0	2300
9340	Yuba City	391	43.6	2890

(1) Herfindahl Index = sum of shares squared.

(2) Includes large CDs of major banks.

102. Using the data in the record in BAC Exh. 72 and BAC Exh. 73 and other documents, it is possible to derive market shares for a universe of deposits held by commercial banks and savings and loan associations in each of the SMSAs in California, and to approximate Herfindahl Indices sufficient for the purposes of this proceeding by using the data in Schweitzer Appendix C, squaring the market shares of the five largest firms in each SMSA, and estimating the maximum possible contribution to the Herfindahl Index from the market shares of the fifth through tenth largest firms. In applying the foregoing methodology to the San Francisco SMSA, approximately $13.2 billion in non-local deposits of Bank of America and approximately $1.2 billion in non-local deposits of State Savings and Loan in the Stockton SMSA should be excluded to avoid distorting the data (Hanna Redirect; Mussa Tr. at 1018; Wiatrak Tr. at 220-21; BAC Exh. 78). Further, Schweitzer Appendix C does not accurately represent the deposit shares of banks and savings and loan associations in the Visalia and

Yuba City SMSAs because it does not contain savings and loan association data for those areas. Based on the share data contained in BAC Exh. 72 and BAC Exh. 73, market shares and Herfindahl Indices for those two SMSAs can be calculated. The Herfindahl Indices and shares of the largest firms in market universes calculated on the basis of deposit data for banks and savings and loan associations in each SMSA in California pursuant to the methodology described above are approximately:

SMSA	*Herfindahl*	*Percentage Share of the Largest Firm*
Anaheim	450	12.5
Santa Barbara	575	12.5
Oxnard	600	15
Los Angeles	625	14
San Diego	775	16
Riverside	800	17
Modesto	850	18
San Jose	850	20
San Rosa	900	18.5
Sacramento	950	24
San Francisco	975	21.5
Stockton	1075	21
Vallejo	1075	27.5
Visalia	1100	24.5
Salinas	1150	18.5
Bakersfield	1200	27.5
Fresno	1250	28
Santa Cruz	1375	21
Yuba City	1575	30

103. An explicit rationale of BAC for the proposed acquisition of Schwab is its desire to expand the Bank's customer base (SIA Exhs. 7, 8, 9, 14; Mussa Rebuttal at 18). It is hoped that present Schwab customers in California will move their banking deposits to the Bank thereby increasing its deposit base

(SIA Exh. 8; McLin Tr. at 46). BAC estimates, and SIA agrees, it may reasonably expect to acquire 15,000 California customers from its association with Schwab. With an estimated gain in deposits of $10,000 per new customer, an overall increase in Bank deposits of $150 million can be anticipated, which represents an overall gain of approximately three tenths of one percent of the Bank's total deposits (Mussa Tr. at 749, 967-68; BAC Exh. 71; SIA Exh. 37).

D. *Voluntary Tie-In*

104. Section 106 of the Bank Holding Company Act, 12 U.S.C. § 1971-78, makes illegal any action by a bank to require a customer to purchase some additional service from the bank in order to receive an extension of credit. The Board has extended this prohibition to bank holding companies through Regulation Y, 12 CFR § 225.4(c)(1). Besides the overt requirement of the purchase of an unwanted product with a desired product, tie-ins may result from implicit coercion when, in view of a firm's market power, a customer purchases two products, one of which is unwanted (*see* H.R. Rep. No. 91-1747, 91st Cong., 2d Sess.; 1970 U.S. Code Cong. & Ad. News 5561, 5564).

105. Joint purchases—that is, purchasing two different goods or services from the same supplier at the same time—occur frequently in most product markets. In fact, millions of joint purchases occur because the potential search costs for the second good or service often exceed the potential savings for the customer from splitting the joint purchase into separate transactions. In other situations, the customer hopes that by making a joint purchase, a long-term business relationship is formed or furthered, which at some future date will become an advantage. The joint purchase made by the customer entirely voluntarily in his best interest cannot be considered a tied sale. In case the customer, in his or her best interest, voluntarily decides that the purchase of several goods or services from a single supplier will yield the most satisfactory purchase, a

voluntary joint purchase has occurred. It is also quite clear that a supplier may explicitly demand that anyone buying a product or service also purchase another service as a condition of supplying the first one. This latter type of coercive tying is illegal under Section 106 of the Bank Holding Company Act (Schweitzer Rebuttal at 1-2).

106. Between the two extremes of explicitly coercive tied sales and purely voluntary joint purchases, a wide variety of tied sale [sic] may occur. They may range from a situation that is characterized by strong "implicit" pressure by the supplier on the customer to make the tied purchase, to a mere suggestion of the seller to the buyer that it might be to his advantage to make the joint purchase. The degree to which these pressures are exerted successfully, or are correctly perceived by the buyer, depends importantly on the market power of the supplier (Schwwitzer [sic] Rebuttal at 2). Whenever an appreciable degree of implicit pressure exists, a joint purchase is no longer purely voluntary because a consumer's decision is influenced or constrained to some extent by the presence of market power in the tying market. On the other hand, a consumer may choose to buy more than one product or service from the same source on the assumption that as a regular customer he will receive a more personal service or some benefit in the future. To prohibit truly voluntary joint purchases would clearly diminish public benefits and would be contrary to the public interest. To force the purchaser to choose their second best alternative would deprive the public of their maximum satisfaction and potential search savings (Schweitzer Rebuttal at 1-2).

107. In the case of banking, the tying product is bank credit. Recent developments in financial services have significantly eroded the uniqueness of the products that commercial banks can offer so that banking concentration does not fully reflect the alternative sources available to the public for all the different banking services in a local market. The inclusion of savings and loan companies and savings banks and other types

of local financial institutions and those outside the area but competing in it, would dilute any market power of local commercial banks. Many alternative bank and non-bank sources of credit exist for locally limited customers (small businesses and consumers) that few borrowers could objectively conclude that any potential coercion or potential retribution exists if the two purchases are made separately. In competitive markets it is far more likely that borrowers judge the joint purchase to be both more convenient and more economical, resulting in some cases in a high proportion of joint purchases (Schweitzer Rebuttal at 5).

108. One of the most important objectives of the Bank's marketing program is the cross-selling of its services to present and prospective Schwab customers (Mendelson Direct at 2-3; Mussa Direct at 29-33; SIA Exh. 11 at 1). As testified to by BAC's Chairman, '[A] substantial effort will be made to offer Bank customers Schwab products and Schwab customers Bank products" (Prussia Direct at 7-9). According to an expert witness for SIA, customers of the Bank may open accounts with Schwab in anticipation of making loan applications to the Bank, especially if the customers believe that they are only marginally qualified to receive the loans (Mendelson Direct at 6; Mendelson Tr. 1057, 1074). BAC, in fact, anticipates that it will gain a substantial number of Schwab customers as Bank customers (*see* F. 103).

109. BAC's Anti-Trust Compliance Manual permits the Bank and BAC's nonbanking subsidiaries to take into account "present and/or past satisfactory relationships" with a customer when selling or pricing a loan (Mendelson Direct at 4; SIA Exh. 19 at 6). However, the manual specifically cautions Bank employees not to create an impression that customers can enhance the likelihood of obtaining services from the Bank by purchasing products which they do not desire from the Bank or its affiliates (BAC Exh. 10 at 7).

110. Cross selling is beneficial to consumers because it (1) lowers consumer search costs; (2) lowers the cost (and thus the price) of goods and services as a result of efficiencies of joint production and sale, and (3) increases the value of goods and services as a result of economies of joint purchase and consumption (Mussa Tr. at 811-12; Schweitzer Rebuttal at 1-2; BAC Exhs. 79-83 [Affidavits of Shearson, E. F. Hutton, Paine Webber, Merrill Lynch, and Bache Halsey]). BAC and its subsidiaries attempt to find cross selling opportunities as a way of lowering their costs and increasing the value of the services they provide (Prussia Direct at 4, 7-8). Securities brokerage firms, particularly full-line brokerage firms, also engage extensively in cross selling. They regard it as important to offer their customers "a variety of financial services and products, including those of its affiliates which offer opportunities for cross selling" (BAC Exh. 82 [Affidavit of Merrill Lynch] at ¶ 8; *see also* BAC Exhs. 79-81, 83; Mussa Tr. at 728-29, 811, 843-44; Prussia Direct at 3-5; Biller Direct at 14; Jacobs Direct at 26-27). To the extent that BAC's acquisition of Schwab results in cross selling packages of financial services to Schwab and Bank customers, the result will be added competition.

E. *Conflicts of Interest*

111. A bank owes a duty to its depositors to evaluate a loan application solely on the basis of whether the loan would provide an adequate rate of return in light of the repayment risk and whether the possibility of default is excessive (Mendelson Direct at 6). When a loan applicant is a customer or potential customer of an affiliated subsidiary, the parent will have an interest in insuring that the customer obtains the loan in order to retain or increase the business of the affiliate and maximize the profitability of the company's subsidiaries as a whole (Mendelson Direct at 7). Thus, a potential conflict of interest exists between the Bank's duty to its depositors and its desire to maximize the profitability of its parent corporation.

112. Schwab performs brokerage services of a type which the Bank uses as a fiduciary of trust accounts (Mendelson Direct at 8). The Bank has an obligation to the beneficiaries of trust accounts it administers to obtain for their accounts the best brokerage services at the lowest possible cost (Mendelson Direct at 8). The Bank will have an incentive to process its trust department securities transactions through Schwab in order to ensure that Schwab has a large order flow and thus meets its high fixed costs (SIA Exh. 34 at 183; Mendelson Direct at 8; Mendelson Tr. at 1092). The Bank's use of Schwab to process its trust account securities transactions would constitute self-dealing to the extent the Bank did not pay the lowest available price for the type and quality of brokerage services necessary (Mendelson Tr. at 1093). The fiduciary duty owed the Bank's trust account customers and BAC's economic interest in using Schwab to process the trust account orders constitutes a potential conflict of interest resulting from the acquisition (Mendelson Direct at 8-9).

113. Soundness of banking practices is a primary purpose of regulatory supervision of banks (Baxter Direct at 43). The Bank employs strict internal standards and safeguards to prevent unsound loans (Jacobs Direct at 37; Johnson Direct at 2-5). The loans made by the Bank are subject to periodic review by federal examiners (Baxter Direct at 44 n. 1; Prussia Direct at 10). The organizational structure and procedures of the Bank provide strong incentives to avoid unsound loans. Branch managers are evaluated on the basis of the performance of their branch, and the loan portfolio of each branch is subject to periodic review by the credit examination arm of the Bank's controller (Jacobs Direct at 38; Prussia Direct at 10). There is no evidence of any compensation or incentive structure that would give branch managers of the Bank an incentive to increase the number of Bank customers using Schwab services (Mendelson Tr. at 1050-51). The Bank's standard procedures do not call for loan officers to obtain information

about an applicant's use of the services of non-bank affiliates, although such association may be revealed in the application papers (Prussia Direct at 10; BAC Exh. 12).

114. Federal laws and regulations impose a duty on the Bank to choose brokerage services upon the basis of "best execution." Trust departments are closely examined by federal regulators and Schwab, in addition, is regulated by the rules and regulations of the SEC and the various exchanges (*see* 12 U.S.C. §§ 371c, and 12 CFR § 9.5; Mendelson Direct at 8; Biller Direct at 40). In addition, Bank would be subject to suit for failure of its fiduciary responsibilities. BAC has established procedures for its trust department to insure that it fulfils its fiduciary responsibilities (Ireland Direct at 2-5). There is no record evidence that BAC has, or will, engage in conflicts of interest that will cause undue consumer harm.

115. Members of SIA (including their affiliates) sometimes have multiple interests in dealing with a customer. To the extent that such multiple interests give rise to potential conflicts of interests, these customers are protected both by law and by internal controls of these firms. SIA members regard applicable legal requirements as sufficient to protect their customers' interests (BAC Exh. 80 at ¶ 8; BAC Exh. 81 at ¶ 8; BAC Exh. 82 at ¶ 10; BAC Exh. 83 at ¶ 10). There is no evidence that the acquisition of Schwab by BAC would give rise to any conflicts of interest different in character or magnitude from those which broker/dealers and their affiliates experience.

F. *Public Confusion*

116. BAC plans to use the logo "A BankAmerica Financial Services Company" in its promotional materials to describe Schwab (BAC App. at 57; Mendelson Direct at 9). BAC intends to establish a separate division of Schwab called "Bank Brokerage Services" and to place Schwab kiosks in Bank brances [sic] (Mendelson Direct at 10). BAC also plans to put Schwab officers on the premises of certain of BAC's Finance-

America offices (McLin Tr. at 34-35). The Bank and Schwab have begun a program allowing Bank's customers to use a Bank checking account or savings account as a payment mechanism for a Schwab brokerage account (Mussa Direct at 33; McLin Tr. at 30; McLin Rebuttal at 3; SIA Exh. 13 at 205-212). According to an expert witness for SIA, customers will believe that the Bank's financial resources stand behind Schwab in some manner and not realize that "BankAmerica" refers to the holding company and not the Bank (Mendelson Direct at 9-10; Mendelson Tr. at 1094).

117. BAC asserts that its association with Schwab will help Schwab overcome investors' apprehension of using discount brokers (BAC Application at 28, 29; BAC Proposed Findings 127-128). BAC's present marketing plans for Schwab do not misrepresent any aspect of Schwab's affiliation with BAC or the Bank (McLin Direct at 10; McLin Rebuttal at 2–5). Under the kiosk project the service will be identified to customers as "Stock Brokerage Services . . . Provided by Charles Schwab & Co., Inc." (McLin Rebuttal at 2). Customers wishing to place orders will deal directly with Schwab (McLin Rebuttal at 3-4).

118. While the precise liability of the Bank for the obligations of Schwab may not be fully comprehended by consumers (although the Schwab customer base consists of "Upscale" retail banking customers who have average incomes of about $60,000 per year—SIA Proposed Finding 311, and are knowledgeable concerning their investment alternatives—SIA Proposed Finding 95), Schwab will be a in a stronger financial and management position after its acquisition by BAC than before the acquisition (F. 76-81). Thus, there is little liklihood [sic] that consumer confusion about the nature of the affiliation between Bank and Schwab would occur or lead to any undue public harm.

G. *BAC's Incentives To Subsidize Schwab Services*

119. BAC regards cross selling of brokerage services to bank customers and banking services to brokerage customers an important aspect of the Schwab acquisition. In particular, BAC intends to develop new and attractive packages of brokerage and banking services to compete for customers and to win their business away from other providers of financial services, including brokerage firms (Prussia Direct at 3-5, 7; *see also* F. 103).

120. Banks earn greater than normal profits from the sale of certain banking services, such as on deposits with regulated interest ceilings and with low service costs relative to average balances (Mussa Direct at 23; Baxter Tr. at 434). Therefore, banks spend money to try to induce customers to put money into savings accounts on which the interest rate is regulated. For example, banks recently expended funds to obtain deposits in interest regulated All-Savers certificates (Baxter Tr. at 436). Banks also offer below-cost services in order to attract deposits into interest-regulated accounts (Baxter Tr. at 436). Banks also offer below-cost services in order to attract deposits into interest-regulated accounts (Baxter Tr. at 436; Jacobs Tr. at 558), and will continue to look for new avenues to attract more money into their regulated savings accounts (Baxter Tr. at 436).

121. A bank holding company has an incentive to subsidize the activities of a non-banking subsidiary, to the extent that the subsidized activities assist the affiliate bank in selling those services which earn greater than normal profits (Mussa Direct at 20; Mussa Tr. at 802). Further, a bank holding company may continue to subsidize a subsidiary so long as itstotal [sic] subsidy is compensated by other profits which are earned as a result of the subsidization (Mussa Direct at 20).

122. One of the benefits BAC expects to derive from its acquisition of Schwab is the ability to cross-sell the Bank's services to Schwab's upscale customer base (Mussa Direct at 29-32; Mussa Tr. at 801; SIA Exh. 55; *see also* F. 103). BAC expects to earn significant additional profits from this cross-

selling (Mussa Tr. at 801-02). BAC estimates that the acquisition of Schwab will result in adding over 15,000 additional California customers and 70,000 additional non-California customers to the bank (SIA Exh. 14 at 30; Mussa Direct at 35; Mussa Tr. at 814). Each additional upscale California and non-California customer is expected to add $150.00 and $30.00 respectively to the Bank before tax earnings for an annual increase in profits to BAC of $4.7 million (SIA Exh. 14 at 30; Mussa Direct at 34-35).

123. BAC has no plans to sell Schwab brokerage services below cost as a way of increasing the opportunity to cross sell its banking products (McLin Tr. at 39). None of the numerous acquisition documents in the record even suggests that BAC would embark on such a course of action (*see e.g.*, SIA Exh. 5, 7-10, 13, 14, 16-18, 20-34, 42, 44, 55, 56, 59). BAC's plans to gain Bank deposits from cross selling Schwab services does not call for any subsidy of Schwab's commission rates; the gain would come from convenience and efficiencies. In fact, BAC has an expectation that each affiliate will return 15 percent on equity capital (McLin Tr. at 24-25). BAC will not invest in Schwab unless it can anticipate an attractive long-term return on investment compared to alternative uses available for BAC funds (Prussia Direct at 8). Further, any subsidization of Schwab services would offset any gains to BAC from the practice, making subsidization largely self defeating.

CONCLUSIONS

I. *BAC's Proposed Acquisition Does Not Violate The Glass-Steagall Act*

The Glass-Steagall Act ("GSA") was enacted in 1933 in response to the economic crises of the 1930's and concomitant bank failures. As the Supreme Court noted in *Board of Governors v. Investment Co. Institute*, 450 U.S. 46, 61-62 (1981):

> "It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression. Congress was persuaded that speculative activities, partially attributable to the connection between commercial banking and investment banking, had contributed to the rash of bank failures. The legislative history reveals that securities firms affiliated with banks had engaged in perilous underwriting operations, stock speculation, and maintaining a market for the bank's own stock, often with the bank's resources." (Footnotes omitted)

The GSA contained many important provisions designed to improve the banking system, such as the creation of the Federal Deposit Insurance Corporation. However, through the years, the term GSA has generally come to refer to only four of its sections—those dealing with securities activities. These provisions may be summarized briefly as follows:

1. Section 21 of the Act, 12 U.S.C. 378, makes it a felony for an organization that receives deposits to "engage at the same time in the business of underwriting, selling or distributing . . . stocks, bonds, debentures, notes or other securities . . ."

2. Section 20 of the Act, 12 U.S.C. 377, prohibits affiliation between member banks and companies "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities . . ."

3. Section 32 of theAct, 12 U.S.C. 78, prohibits interlocking personnel relationships between member banks and companies "primarily engaged" in the securities business described in Section 20.

4. Section 16 of the Act amended an existing provision of the banking law (R.S. 5136, 12 U.S.C. § 24 (1970)) to (a) prohibit national banks and state member banks from purchasing any equity securities, (b) impose additional limitations on

their investment authority with respect to debt obligations, and (c) prohibit their underwriting and dealing in securities except for U.S. Treasury and other agency obligations and general obligations of states and municipalities. As thereafter amended by the Banking Act of 1935, Section 16 provides, in pertinent part, that: "The business of dealing in securities and stocks by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of [sic] customers and, in no case, for its own account, and the association shall not underwrite any issues of securities or stock . . . . Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the corporation for its own account of any shares of stock of any corporation." 49 Stat. 709, Aug. 23, 1935, c. 614, § 308.

Immediately following the passage of the GSA, agencies and courts were reluctant to allow more than the most limited form of investment activity by banks. In 1936, for example, the Comptroller of the Currency allowed the purchase and sale of securities by national banks only to existing bank customers and only if the bank received prior payment or had customer assets on hand to cover the transaction.

The scope of permissable [sic] securities activity has been greatly expanded since that time. The Comptroller has acknowledged that earlier interpretations of the banking regulations were reactions to the economic situation of the 1930's and interpret the GSA erroneously. *See Security Pacific National Bank*, Slip Op. August 26, 1982, decision by the Comptroller of the Currency at 4.

The rejection of the restrictive reading of the Act is supported by a number of judicial decisions. In *Investment Co. Institute v. Camp*, 401 U.S. 617 (1971), the court analyzed a bank's participation in the organization, distribution and marketing of shares in an investment company. The court held that the activities involved a bank in the underwriting and distribution of securities in direct controvention [sic] of Sections 16 and 21 of the GSA. However, in so holding, the court

expressly acknowledged that nothing in the law would prevent a national bank from purchasing stock for the account of its customers. 401 U.S. at 624.

In *Investment Co. Institute, supra*, the court found a Board regulation permitting bank holding companies and nonbanking subsidiaries to act as investment advisors to closed-end investment companies not to violate the GSA. The court distinguished the restriction of Section 21 which limits the scope of permissible activities of banks, and Section 20 which limits the activities of bank affiliates:

> Even if we were to assume that a bank would violate the Glass-Steagall Act by engaging in certain investment advisory services, it would not follow that a bank holding company could never perform such services. In both the Glass-Steagall Act itself and in the Bank Holding Company Act, Congress indicated that a bank affiliate may engage in activities that would be impermissible for the bank itself. Thus, § 21 of Glass-Steagall entirely prohibits the sale firm from engaging in banking and in the underwriting business, whereas § 20 does not prohibit bank affiliation with a securities firm unless that firm is "engaged principally" in activities such as underwriting. [footnote omitted] (450 U.S. at 63-64)

Thus, the court acknowledged that affiliates of bank holding companies are to have greater authority to carry on activities related to securities transactions than are banks.

It is clear, therefore, that Section 20 is the principle provision to be examined in the context of the BAC application; it deals with relationships of member banks and securities affiliates. The section prohibits affiliates from engaging principally in "the issue, flotation, underwriting, public sale or distribution" of securities.

Schwab buys and sells securities solely on the order and for the account of customers. It does not engage in market making or more than a minimal amount of dealing or underwriting.

The only securities transactions in which Schwab engages that might be characterized as other than agency transactions are the "inadvertent principal" transactions that arise as a result of errors in executing customer orders, the "riskless principal" transactions in connection with the purchase and sale of new issue municipal bonds, and the "sweep" arrangement with the Kemper Cash Equivalent Fund. Together these activities constitute a very minor portion of Schwab's business (F. 12, 13, 64-66). Thus, Schwab is not "principally" engaged in the "issue, flotation [or] underwriting" of securities.

The principal barrier to the acquisition of Schwab by BAC, therefore, is the remaining language of the section prohibiting the "public sale" of securities. The meaning of this phrase in Section 20 and its relationship to brokerage activities has not been explicitly defined (*see* Board Counsel's Post Hearing Brief at 20). Section 32, however, which contains parallel and virtually identical language equivalent to that of Section 20, has been interpreted by the Supreme Court.

In *Board of Governors v. Agnew*, 329 U.S. 441 (1947), the court apparently accepted the proposition that the Section 32 language did not refer to brokerage activity. The court in *Agnew* addressed the issue of the applicability of Section 32 of the GSA, which prohibits simultaneous employment of persons in both a securities firm and a bank, to a question of whether a securities firm, Eastman Dillon & Co., was primarily engaged in underwriting activities of the type enumerated in Section 32. Like the Board and the court before it, the Supreme Court accepted an interpretation of Section 32's securities underwriting language which clearly excludes brokerage activities from the section's limitation. The court determined that only the gross income from the underwriting field, which consists of income from "[T]he issue flotation, underwriting, public sale or distribution . . . of stocks, bonds or other similar securities . . ." (329 U.S. at 445 fn.3), should be considered in a determination of whether the statute had been violated. Gross income from brokerage business was not to be considered in

any determination as to whether a firm was "primarily engaged" in any activity violative of the act. This interpretation that the phrase "public sale" excludes brokerage activities is consistent with earlier Federal Reserve Board interpretations.[6]

As noted above, the only activities in which Schwab engages that even remotely raise a question under the language of Sections 20 and 32 are Schwab's "sweep" arrangement with the Kemper Cash Equivalent Fund, a money market fund, the "riskless principal" transactions in connection with the purchase and sale of new issue municipal bonds,[7] and the "inadvertent principal" transactions that arise as a result of errors. None of these activities, as performed by Schwab, are significant enough to warrant finding the proposed acquisition to be a violation of the GSA. In no event do they constitute a "principal" activity within the meaning of Section 20 as interpreted by the court in *Agnew* (329 U.S. at 446-49).

In determining the propriaty [sic] of permitting a bank holding company to acquire a discount brokerage firm the undersigned is mindful of the intent of the framers of the GSA. While Congress meant to "seperat[e] [sic] as completely as possible" commercial from investment banking, *Board of Governors v. Investment Co. Institute,* 450 U.S. at 70, it specifically authorized banks to carry on some securities activities. Section 16 of the Act sets forth the permissible securities activities of banks that are members of the Federal Reserve System as follows:

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6 The Board determined in 1936 that:

> A broker engaged in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32. (12 CFR § 218.1 n. 1 (1936)).

7 The purchase and sale of municipal bonds are authorized for banks and need not be considered (12 U.S.C. 24 (Seventh) [sic]. Banks in the past have engaged in trading in municipal bonds on a substantial scale (F. 41).

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. 12 U.S.C. § 24 (Seventh).

The only discussion of the Section 16 limitation on brokerage activities and their function, as contemplated by the GSA, is contained in the Senate Report which explains the purpose of Section 16:

> Section 16.—Undertakes to broaden the national laws by giving national banks all powers possessed by State banks of deposit and discount organized in the States in which such national banks are located, except in so far as they may be prohibited by Federal legislation. National banks are to be permitted to purchase and sell investment securities for their customers to the same extent as *heretofore* . . ." (Emphasis supplied). S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933).

Because Congress intended to permit banks to continue the securities activities engaged in prior to the enactment of the GSA, it is necessary to examine the pre-1933 brokerage functions of national banks.

Prior to enactment of the GSA brokerage activity by national banks was so widespread it was subject to judicial notice. *Block v. Pennsylvania Exchange Bank,* 253 N.Y. 227, 170 N.E. 900 (1930). Among the practices undertaken by banks were the charging of customer accounts for purchases rather than having the customer draw a check to cover the purchase price, the charging of a service fee for transactions and the dealing in both debt and equity investments. *See e.g., Blakey v. Brinson,* 286 U.S. 254 (1932), and *McNair v. Davis,* 68 F.2d. 935, (5th Cir. 1934), *cert. denied,* 292 U.S. 647 (1934).

More recently, Section 16 has been interpreted so as to permit increasing brokerage-type activity by banks. In

N.Y.S.E. v. Smith, 404 F. Supp. 1091 (1975), *vacated and remanded for dismissal on other grounds,* 562 F.2d 736 (D.C. Cir. 1977), *cert. denied,* 435 U.S. 942 (1977), the court validated a ruling of the Comptroller of the Currency holding that automatic stock-purchasing services offered by National banks did not violate the GSA. Automatic Investment Services ("AIS") provide participants the opportunity periodically to invest predetermined amounts in equity securities selected by them from a list compiled by an administering bank. Banks purchase the necesary [sic] shares in the market and hold the shares for the account of the participants. AIS's were first introduced in 1973, prior to the unfixing of brokerage commissions. They provided a means by which individual purchasers of small numbers of shares could take advantage of lower commission rates for bulk sales (see F. 38).

Plaintiff in *N.Y.S.E. v. Smith* contended that even though the AIS met the letter of Section 16, it failed to comply with the spirit of the Act. Plaintiff argued that Section 16 was intended to be a narrow exception to the general ban on participation in securities-related activities limited to providing a service for established customers as a courtesy. The Plaintiff also argued that the supplying of free checking accounts to AIS participants rendered compliance with the statutory requirement of a customer relationship a mere technicality. In finding no violation of the spirit of the GSA the court reiterated the Supreme Court's reasons for finding a conflict between allowing a bank-managed investment fund and the purposes of Section 16, as stated *Investment Co. Institute v. Camp, supra.*[8]

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8 The reasons advanced by the court for finding a conflict between a bank-managed investment fund and the strictures of Section 16 of the GSA were: (1) the fund gave the bank a salesman's interest in the investments; (2) the bank had a salesman's interest in the sales of shares in the fund; (3) the bank's prestige and credibility were placed in jeopardy; and, less importantly, (4) banks might lend money to corporations in which the fund had invested, or to the fund or customers of the fund in a manner not in keeping with sound business judgment. *See,* Investment Co. Institute v. Camp, 401 U.S. at 636-38.

In concluding that AIS activities violate neither the letter nor the spirit of the GSA, the Court in *N.Y.S.E. v. Smith* noted:

> Banks offering AIS do not have a salesman's interest in the securities' performances. Since the banks do not manage the customers [sic] investments, they need not prove that they perform better than anyone else. This is quite different from the situation in *Investment Company Institute*, where banks were compelled to out perform mutual funds. Under AIS, banks are in competition with investment brokers only in terms of convenience, cost, and dependability. This sort of competition does not engender the threats to bank solvency which concerned the drafters of the Glass-Steagall Act because it is independent of any investment decision. 404 F. Supp. at 1099-1100.

Congress's express grant of brokerage powers to banks (12 U.S.C. § 24 (Seventh); *see also Investment Co. Institute v. Camp*, 401 U.S. at 624), demonstrates that Glass-Steagall's major concern is with bank involvement in underwriting and dealing, and not brokerage. Unlike the underwriting business, the proposed discount brokerage activities engaged in by Schwab will not cause BAC (or its bank subsidiary, Bank of America NT&SA) to put its own assets or funds at risk in the securities markets. It is thus apparent that Glass-Steagall's policy would not be thwarted by allowing bank holding companies to engage in securities brokerage.

In an August 26, 1982 decision, the Comptroller of the Currency approved an application from Security Pacific National Bank to offer discount brokerage services through a subsidiary (*Security Pacific National Bank*, Decision of the Comptroller of the Currency (Aug. 26, 1982)). Although not binding on the Board, the decision is further evidence of a broadening of the scope of permissable [sic] activities of banks. The Comptroller stressed and the undersigned agrees that the kinds of brokerage activities associated with the discount brokerage business do not give rise to risks materially

different from those associated with the securities activities historically pursued by banks and therefore in no way violate the precepts of the Glass-Steagall Act.

II. *Schwab's Activities Are "Closely Related to Banking"*

A. *The Criteria for Determining if an Activity is Closely Related to Banking*

Under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8), bank holding companies are permitted to engage in "activities . . . which the Board has determined . . . to be so closely related to banking or managing or controlling banks as to be a proper incident thereto."

In determining whether an activity is "closely related" to banking, the Court of Appeals for the District of Columbia, in *National Courier Association v. Board of Governors,* 516 F.2d 1229 (D.C. Cir. 1975), set forth a series of guidelines, which have since been adopted by the Board. *See, e.g., Citicorp (Citishare),* 68 Fed. Res. Bull. 505, 506 (1982). Pursuant to these guidelines, an activity will be considered closely related to banking if:

1. Banks generally have in fact provided the proposed services;
2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services; or
3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

(516 F.2d at 1237).

The *National Courier* court noted that the Board is not limited to the above three standards.[9] After recapping the

9 The Board has held that it "may consider other factors in deciding what activities are closely related to banking." Bank-America Corp., slip op. at 3 (Fed. Res. Board Sept. 1, 1982).

National Courier guidelines, the court in *Ala. Assoc. of Ins. Agents v. Board of Governors of Federal Reserve System*, 533 F.2d 224, 241 (1976), stated a willingness "to consider broader types of relationships.[10] In that case the court affirmed the Board's authorization of the sale of property damage insurance by banks despite the fact that there was no history of banks supplying such insurance nor any necessity for a specialized form of the activity. The justification for the approval was the fact that both the bank and the customer were in need of such insurance. As the court noted:

> Where a product or service is regularly desired by both parties and supports the transaction in some significant way, we cannot say that the Board acts irrationally or arbitrarily in deeming the furnishing of the product or service 'closely related to banking' or 'directly related to an extension of credit.' (533 F.2d at 244)

Similar guidelines have been used by the Supreme Court. In *Board of Governors v. Investment Co. Institute*, 450 U.S. 46 (1981), the court sustained a Federal Reserve Board ruling, pursuant to Regulation Y, that acting as an investment advisor to and manager of a closed-end investment company was closely related to banking. The court found the principal activities of the advisor—the investment of client funds and the management of an investment portfolio, were "not significantly different from the traditional fiduciary functions of banks" (450 U.S. at 55-56) and that banks had been engaging in the activities for decades.

Earlier this year the Board characterized the relevant criteria as follows: "As the courts have made clear, a proposed activity that does not differ significantly from the functions that banks traditionally or generally have provided is closely related to

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10 ". . . we believe the Board should be upheld when it articulates any type connection between banking and the non-banking activity in question which makes it rational to consider the proposed activity an 'incident' to banking." 533 F.2d at 244.

banking within the meaning of Section 4(c)(8)." *Citicorp,* 68 Fed. Res. Bull. 249 (1982).

In addition to closely related activities, the Board's Regulation Y authorizes bank holding companies to perform "such incidental activities as are necessary to carry on the closely related activities." 12 C.F.R. § 225.4(a) (1981). The *National Courier* court endorsed this concept stating:

> "[T]he idea is fairly well established that Congress intended some reasonable latitude in the limitations it placed upon the activities of banks and their affiliates. In enumerating the activities that could be carried on, it certainly could not have meant to forbid engagement in such other 'incidental' activities as were reasonably necessary to carrying out those that were enumerated." (516 F.2d at 1240).

BAC's proposed acquisition of Schwab is not barred by Section 4(c)(8) of the Bank Holding Act [sic], because each of the activities intended to be carried on by the new acquisition is either closely related to banking or so related to such activity as to be reasonably necessary in carrying out the closely related activity.

B. *Schwab's Discount Securities Brokerage Activities are "Closely Related to Banking"*

BAC proposes to engage through Schwab, in the business of acting as broker for the purchase and sale of securities upon the order and for the account of customers in substantially the same manner as Schwab currently conducts that business. Schwab presently buys and sells securities solely on the order and for the account of customers. It does not engage in the market making and it gives no investment advice (F. 12). The issue is whether these activities if performed by a subsidiary of BAC are functionally or operationally so similar to activities already performed by banks as to be "closely related" to banking under Section 4(c)(8) of the Bank Holding Company Act ("BHC Act").

Recommended Decision

The record shows that banks have participated in stock brokerage activities through six principal programs (F. 33-41). First, banks have offered Customer Transaction Services, whereby the bank agrees to purchase or sell stock on behalf of and at the direction of the customer. The SEC's Initial Report on Bank Securities Activities concluded that as of 1976, more than 4,300 commercial banks (30%) offered this service (F. 35). Second, banks have offered Dividend Reinvestment Plans, whereby shareholders of a corporate customer of a bank authorize the payment of dividends to a bank that will purchase additional shares of the corporation on their behalf. Some banks provide shareholders the option of investing other funds in the purchase of additional stock. As of 1977, 68 banks (0.5%) administered such plans for 727 companies (F. 36). Third, banks have offered Employee Stock Option Plans that provide a method for employees of a customer corporation of a bank to invest in securities of the corporation by periodic deductions from payroll deposited with the sponsor bank. As of 1977, 59 banks (0.4%) offered the plan (F. 37). Fourth, banks have offered Automatic Investment Services that are brokerage plans initiated by banks that compile a list of 20-30 securities that are subject to purchase and sale by the bank through individual custodial accounts. By purchasing large numbers of shares at one time the bank is able to pass substantial savings in transaction costs to individual purchasers. Since the unfixing of brokerage commissions in 1975, AIPs have not been profitable and have been discontinued by most banks that offered them. As of 1977, 18 banks (0.1%) provided the service (F. 38). Fifth, it has been shown that brokerage activities on behalf of bank trust accounts constitute the largest portion of bank securities brokerage activities. The trust departments of banks offer service to a wide variety of customers, the services provided include arranging for the purchase and sale of securities, holding securities for trust accounts; collecting dividends and crediting them to interest bearing accounts. Banks may or may not offer investment

advice to these customers (F. 39-40). Sixth and finally, banks are active participants in marketing obligations of the United States and its agencies, general obligations of states and municipalities, municipal revenue bonds, and money market instruments such as certificates of deposit and bankers acceptances (F. 41).

As the SEC concluded in its "1977 Final Report on Bank Securities Activities," many such bank activities are "functionally equivalent to those of broker-dealers." In particular, the SEC concluded that "with respect to the purchase and sale of securities for their managed accounts, bank trust departments are performing in many respects the same activities as are performed by retail brokerage firms" (BAC Exh. 54 at 6, 121). The SEC also concluded, "the extent of this bank activity is substantial, both for trust department accounts and brokerage-type services" (BAC Exh. 54 at 14).

Banks are not members of exchanges and, therefore, do not execute customer orders themselves on exchanges. However, this is also true of many brokers, such as "introducing brokers," who rely on third parties to execute transactions involving listed securities. Until June 1982 Schwab relied on Pershing & Co. to execute and clear its trades on the New Your [sic] Stock Exchange; Schwab still uses Pershing for its options trading. Third party correspondent brokers, such as Pershing, offer the same execution and clearing services to both banks and brokerage firms. Even brokers that are members of exchanges on occasion rely on third parties to execute their transactions (F. 46). A customer rarely knows the manner in which his bank broker executes his order. Therefore, from his perspective, the results produced by asking a bank to act as agent to buy or sell a security and asking a securities broker to perform the same transaction, are identical.

Recently, a large number of banks have begun to provide expanded brokerage services to their customers pursuant to contractual arrangements with a variety of brokerage firms, including discount brokerage firms. On August 26, 1982, the

Comptroller of the Currency specifically authorized Security Pacific National Bank to provide discount brokerage services through a new subsidiary. And on September 20, 1982, the Comptroller approved the application of Union Planters National Bank of Memphis to acquire Brenner Steed & Associates, a discount brokerage firm. The Federal Deposit Insurance Corporation has similarly affirmed that banking institutions subject to its jurisdiction may engage in expanded securities brokerage activities through subsidiaries (F. 42, 43).

While there is not an exact correlation between those brokerage activities conducted by banks and securities firms, the differences are not fundamental and are matters of degree. Possibly the largest difference is the fact that banks have not frequently dealt with other than their banking customers. However, it is not consistent with the purposes of section 4(c)(8) to require a linkage of the security activity to its provision to the general public. The court in *National Courier Ass'n, supra,* explicitly recognized the irrelevance of the nature of the customer for closely related services when it observed that courier activities performed by a banking holding company affiliate

> " . . . may be between two places of business neither of which is a bank, a bank affiliate, or a customer of either. A bank related courier may thus carry the financially related records of a firm with which it has no dealings . . . to the independent data processor of that firm's choice." (516 F.2d at 1239).

SIA's principal quarrel with this "closely related" issue centers on the fact that banks have not executed trades on the major exchanges and the volume of brokerage activities transacted by banks has been small when compared to total brokerage revenues. Banks for many years have performed all brokerage activities except execution on major exchanges. Their brokerage activities in all other respects are operationally or functionally equivalent to or identical to the activities of

brokers, making banks particularly well equipped to engage in all brokerage activities. Further, over the course of past years the dollar volume of brokerage transactions by banks has been significant.

The differences that have existed between the securities activities of banks and full brokerage firms are the result of historical and economic circumstances. The pre-1975 environment of fixed brokerage commissions, coupled with the ineligibility of banks to become members of exchanges, precluded banks from profitably participating in the offering of brokerage services. These differences should not serve as a basis for further limitation of bank or bank holding company involvement in the brokerage industry.

C. *Margin Lending is "Closely Related to Banking"*

Schwab's margin lending activities are also closely related to banking. Banks have traditionally offered margin credit to their customers, pursuant to Regulation U of the Federal Reserve Board. Regulation U, which limits the amounts that banks may lend on stocks, has been in effect since 1936. As of the end of 1981, commercial banks had approximately $5 billion in loans outstanding to purchase or carry securities by borrowers other than brokers, securities dealers or other financial institutions. Margin lending by brokers is governed by Regulation T of the Federal Reserve Board. The fundamental activity in broker margin lending—making secured loans to individual customers—is functionally equivalent to bank margin lending, as well as general secured lending which is a fundamental bank activity (F. 41).

Margin lending is a major activity of brokers. Margin lending revenue accounted for 14.7% of total broker revenue in 1979 (F. 22). Forty-five percent of all trades executed by Schwab are conducted in margin accounts (F. 47). Thus, margin lending is also reasonably necessary to brokerage activity.

D. *IRA Accounts and Securities Custodial Services Offered by Schwab are Operationally and Functionally Equivalent to Services Offered by Banks*

BAC proposes to offer its brokerage customers access to a self-directed IRA account under an arrangement with an unaffiliated savings and loan association as trustee. Many banks offer IRA accounts to their customers. Numerous brokerage firms offer self-directed IRA account services to their customers (F. 49). Brokerage firms offer these accounts to compete effectively and to serve the needs of their customers. It, therefore, seems uncontroverted that the offering of such a service is an activity "closely related" to banking.

BAC also requests authority to offer securities custodial services similar to those currently offered by Schwab. Virtually all brokers offer custodial services whereby customers' securities are registered in street name and held in a depository on behalf of the customer. This activity entails safe keeping [sic], and accounting for dividends and interest received on securities so held and other ancillary administrative services (F. 48).

Schwab and other brokerge firms currently provide this service and, indeed, are required to keep possession of securities that are the subject of margin loans. Cash account securities certificates may be held by the customer, but approximately thirty-five percent of Schwab's cash account customers elect to use its custodial services. Approximately fifty percent of all Schwab customers use its custodial services (F. 48).

Banks have historically provided safekeeping and custodial services and bank holding companies may legally provide custodial service incident to their trust and advisory activities (12 C F R. §§ 9, 225 4(a)(4) and 225.125(i)). Bank holding companies may provide such services incidental to securities brokerage activities. *See, JCT Trust Co.*, 67 Fed. Res. Bull. 635 n.2 (1981). Accordingly, BAC's proposed securities custodial services are both closely related to banking and incidental to its proposed brokerage activity.

E. *Schwab's Investment Alternatives for Customer's Idle Funds Are Both Closely Related to Banking and Incidental to a Closely Related Activity*

BAC proposes to offer its customers the ability to invest their available cash balances, pending further investment, in securities. BAC proposes at least three alternatives:

(i) a "sweep" arrangement to an unaffiliated Kemper Cash Equivalent Fund, Inc.

(ii) payment of interest on net free balances

(iii) the Schwab One account, a cash management account, whereby, in addition to the payment of interest on free credit balances, the customer is provided a more comprehensive package of financial services, including a VISA credit card.

The record shows that these three services are widely offered by brokerage firms at the present time (F. 57-63).

During recent years, as the impact of inflation has increased the cost of having idle funds that do not earn a return and as consumers have become increasingly sensitive to the cost of leaving [sic] funds underutilized, brokerage firms have begun to make available to these customers a return on the cash balances in the customers' accounts. Virtually all brokers of any significant size offer their customers some mechanism through which they can earn a return on the available funds in their accounts pending further investment (F. 57).

Sweep Accounts are one method by which many brokerage firms, as well as banks and savings and loan associations, provide for a return on funds in customer accounts. Sweep accounts are money market funds that link existing security brokerage accounts and/or bank accounts to productive investments. Essentially, amounts above a specified minimum are regularly "swept" out of a customer's account with a bank or brokerage firm and into a money market fund, where it earns a higher rate of return. At present a number of brokers and

depository institutions offer retail sweeps in conjunction with independent money market fund management companies such as Fidelity, Federated, Kemper, or Dreyfus. Banks offering such sweep accounts include Chase and Bank of New York. Federated now claims to be offering this service to more than one hundred banks (F. 58).

In addition to offering "sweep" arrangements, some brokers, including Schwab, also pay interest directly on temporarily idle funds in their customers' accounts (interest on net free balances). The direct payment of interest on customer cash balances by brokerage firms is functionally equivalent to the payment of interest by banks on accounts such as savings accounts (F. 59).

Cash Management accounts are another means by which brokerage firms service their customers. It is a hybrid account, offering a number of financial services. Its main features usually include (I) [sic] the opportunity to earn interest on net free balances in a brokerage account, through either a money market fund functioning as a sweep account or the direct payment of interest, (2) a mechanism by which the customer can more readily redeem his funds, whether by check or by debit card, (3) the use of margin accounts to secure borrowing against eligible securities, (4) automatic features that tend to maximize returns received, through the establishment of a hierarchy of investments and redemptions (such that withdrawals are made from the least renumerative [sic] funds and investments are made to the highest yield funds), and (5) integrated monthly statements showing all account activity and balances (F. 60). Banks have been participants in the provision of cash management accounts since their initiation (F. 61).

All of the elements of these proposed mechanisms for utilizing idle customer funds are closely related to banking services. They are also increasingly necessary for effective competition for brokerage business (see F. 23, 57), and are therefore permissable [sic] under the Board's Regulation Y, which permits "incidental activities . . . necessary to carry on

the closely related activities" (12 C.F.R. § 2254(a)(1981)). The activities are also operationally or functionally equivalent to activities that banks are and have been engaged in, and are closely related to banking.

F. *Schwab's Inadvertent Principal Transactions and Money Market Fund Activity are Incidental to the Permitted Brokerage Activities*

"Inadvertent principal" transactions occur when Schwab makes a mistake in purchasing securities on behalf of a customer and must maintain (and then liquidate) the unwanted shares for its own account. Principal positions that arise as a result of errors are an unavoidable incident to the ordinary conduct of any agency securities transaction business and typically create a loss. Inadvertent principal positions arise in well below onepercent [sic] of all Schwab's business, which is incidental to their brokerage activities (F. 64).

Schwab offers a "sweep" arrangement in conjunction with the Kemper Cash Equivalent Fund (the "Fund"), a money market fund that is advised and administered by Kemper Financial Services, Inc. ("Kemper"), [sic] Schwab acts only as an agent for its customers in dealing with the Fund. It arranges for the purchase of shares in the Fund on behalf of the customers, processes the transfer of payments between the Fund and the customers' accounts, and generates periodic records for its customers reflecting their investment in the Fund. Schwab does not purchase shares in the Fund for its own account for resale to its customers, and receives no remuneration from its customers for these services it performs. The Fund maintains on its books the names of the Schwab customers holding an investment with the Fund and transmits all proxy materials directly to them. Under its agreement with Kemper, Schwab receives compensation from Kemper calculated on a sliding scale of different amounts in the Fund. Schwab is compensated for its *pro rata* share of the entire amount in the Fund, based on the shares its customers hold in

the Fund pursuant to Schwab's agreement with Kemper. For the fiscal year ending September 30, 1981, Schwab's payments from Kemper constituted less than one percent of Schwab's revenues (F. 66).

As noted earlier, sweep arrangements are "incidental" to the carrying on of a brokerage business and are therefore permissable [sic] under Regulation Y. The fact that Schwab earns less than one percent of its revenues from its arrangement reenforces [sic] this determination. As previously noted, banks presently offer sweep arrangements, leading to the plain conclusion that such arrangements are closely related to banking (F. 58).

III. *Public Benefits From The Acquisition*

A. *The Criteria For Determining Public Benefits*

Section 4(c)(8) of the Bank Holding Company Act provides, in part, that

> "in determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects."

12 U.S.C. 1843(c)(8).

In *Independent Ins. Agents of America, Inc. v. Board of Governors of the Federal Reserve System*, 658 F.2d 571, 573 (8th Cir. 1981), the court, in respect to the "public benefits" tests under 12 U.S.C. § 1843(c)(8), stated:

> "The Board in reviewing an application under 12 U.S.C. § 1843(c)(8), must make two separate determinations before such application can be approved. First, it must determine whether, as a general matter, the proposed activity is closely related and incidental to banking.

> *See, e.g., Connecticut Bankers Ass'n v. Board of Governors of the Federal Reserve System*, 627 F.2d 245, 249 (D.C. Cir. 1980). Second, it must determine whether the public benefits of the proposed activity will outweigh potential adverse effects. *Id. Accord, Independent Ins. Agents of America v. Board of Governors of the Federal Reserve System*, 646 F.2d 868, 869 (4th Cir. 1981) (per curiam). Twelve U.S.C. § 1843(c)(8) provides that in making the second determination, often referred to as the "public benefits" test, the Board must consider whether approval of the application "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices." Under this two-step procedure, the Board can find that the proposed activity is closely related to banking in general but, nevertheless, deny the application because it fails the "public benefits" test. *See, e.g., Connecticut Bankers Ass'n v. Board of Governors of the Federal Reserve System, supra*, 627 F.2d at 249-250 nn. 19-21."

In making the "public benefits" determination:

> "[C]ongress required only that public benefits 'reasonably' be expected to outweigh adverse effects. In so doing, it indicated recognition of the fact that the judgments required of the Board are necessarily imprecise and to some degree speculative. Not only do they relate to complex future events—often unprecedented ones—but they concern aggregate rather than discrete effects. Thus, the Board must determine not whether there will be one or more aspects of insurance agency activity by holding company affiliates that will tend to produce efficiency gains, but whether, overall, such aspects will outweigh possible sources of efficiency loss sufficiently to produce

net gains. The latter determination is much more difficult than the former, and is one which is much less susceptible to detailed evidentiary support. Unless we are to impose insurmountable barriers upon those who seek to take advantage of the § 4(c)(8) authorization, which was reaffirmed by Congress in 1970, our review must be sensitive to these circumstances. *See, e.g., Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 292-94, 95 S. Ct. 438, 446, 42 L.Ed. 2d. 447, 460 (1974)."

Ala. Ass'n. of Ins. Agents v. Board of Governors of the Federal Reserve System, 533 F.2d 224, 246 (5th Cir. 1976). The burden of proof on the "public benefits" issue is on the applicant. *Id.* at 235 fn. 6.

B. *Summary of Public Benefits*

BAC's acquisition of Schwab will help make Schwab a more effective competitor and will allow BAC to compete vigorously in the emerging financial services industry. The strengthing [sic] of Schwab as a competitor is likely to result (a) from Schwab's greater acceptance by brokerage customers, (b) from support given Schwab in terms of capital spending (for office expansion, technological innovation and other purposes), management resources, and technological assistance,[11] and (c) from increased operational efficiencies. By making Schwab a more effective competitor, the acquisition promises to force competitive responses from other brokers, full-line firms and discounters alike, thereby increasing price and service competition in the brokerage industry.

BAC is a large multinational financial services conglomerate. It has a large management staff with great expeeence [sic] in many fields including areas where Schwab has not ventured.

11 In 1980, Schwab had to abandon an attempt to access the public capital market because it feared a lack of public response due to its financial statements—bad debts and error ratios (BAC Application at 31; SIA Exh. 34 at 5).

For example, BAC has large scale foreign operations, an area where Schwab is just entering. BAC also has acquired technical skills in many operations, including data processing. BAC's management and technical resources should be of significant advantage to Schwab. In addition, the acquisition will allow BAC to participate in the increased competition that is occurring among many different types of financial institutions. As the differences among products offered by these institutions continue to blur, a more integrated financial services industry is emerging. The most successful new products include the transaction service offerings by brokerage firms which have provided attractive alternatives to the types of services previously offered only by banks. The proposed acquisition represents one way BAC seeks to respond to the competitive initiatives of brokers and to play a more competitive role in the broader financial services marketplace.

There has been a long-term trend toward consolidation within the securities industry as firms perceived the need to strengthen their financial structure and create a more permanent capital base. This trend has intensified in recent years as firms seek to compete more successfully with diversified financial firms, and to achieve economies of scale in such areas as data processing, communication, advertising and marketing (F. 23). The acquisition of Schwab by BAC strengthens Schwab in all of these areas.

C. *Increased Price Competition in Retail Brokerage*

BAC has presented straightforward propositions that enchanced [sic] acceptance of Schwab, coupled with Schwab's emphasis on competing on the basis of discount prices, will create public benefits in the retail brokerage industry where prices now are treated by the largest brokerage firms as trade secrets.[12]

12 *See* Affidavit of Raymond V. Thomas at 6-7, appended as Attachment 1 to the Memorandum in Support of Joint Motion to Quash Subpoena Duces Tecum Dated August 19, 1982 (August 30, 1982).

Prior to May 1, 1975, securities brokerage firms in the United States provided most brokerage services first on a minimum and later on a fixed commission basis. As a result, price competition in the industry was virtually nonexistent, although brokerage firms did compete in the provision of services, including investment research and advice. After fixed commission rates were abolished, a high degree of price competition was quickly introduced into the "institutional" part of the brokerage business. With respect to individual customer transactions, however, the result was very different.[13] The large, established "full-line" brokerage firms have continued to compete on a service basis, without disclosing their commission rate policies.

Since May 1, 1975, "discount brokers" like Schwab, which compete for retail securities brokerage business on the basis of both services offered and price, have gradually emerged. The growth of discount brokers (F. 30) clearly indicates a substantial interest among consumers in obtaining brokerage services at a lower price and without "bundled" investment advice. There is reason to believe, moreover, that many customers of full-line brokerage firms who are potential customers of discount brokers, do not yet use such brokers. Among other reasons, this is because discounters are relataively [sic] new and relatively small and not well-established in the marketplace. As of 1981, discount brokerage firms accounted for only 6.1 percent of total industry commission revenues (F. 30).

The magnitude of the potential public benefit from increased price competition in the market for brokerage services is substantial. A distinguishing feature of "discounters" is that they advertise their prices aggressively. "Advertising is the traditional mechanism in a free-market economy for a supplier to inform a potential purchaser of the availability and terms of

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13 Commission rates on a per share basis to individuals show that they experienced an increase of 18.4 percent in trades under 200 shares, and an increase of 16.6 percent in trades between 200-900 shares (BAC Exh. 55, p. 83-93).

exchange." *Bates v. State Bar of Arizona,* 433 U.S. 350, 376 (1977). "Advertising serves to inform the public of the availability, nature, and price of products and services, and thus performs an indispensible role in the allocation of resources in a free enterprise system. Advertising serves individual and societal interests in assuring informed and reliable decision-making." *Id.* at 364. Price advertising places pressure on sellers to reduce prices, instills cost consciousness in providers of services and informs the public about price alternatives. *Advertising of Ophthalmic Goods and Services,* 43 Fed. Reg. 23,992, 23,994-95 (FTC June 2, 1978).

It is price competition that is the "central nervous system of our economy." *United States v. Socony Vaccum [sic] Oil Co.,* 310 U.S. 150, 226 n. 5 (1940). Increased competitive pressure on prices may well require full-line firms to lower their prices or increase their discounts.[14] When subjected to more price competition, some, if not all, such firms may decide to price brokerage services separately from research and advice services, allowing the market to allocate these services in a more direct and efficient way. Whether or not such "unbundling" occurs, strengthening Schwab in particular and discount brokers in general has substantial potential for benefitting investors by increasing price as well as service competition.

D. *Increased Competition for Technological Innovation*

The acquisition will help Schwab remain a leader in embracing new technologies that will continue to allow brokers to cut costs, reduce error rates, and generally provde better service. While Schwab has taken advantage of and led in the application of new technology to brokerage transactions, including an "on line" [sic] system of customer accounts and extensive use

14 "Quite simply, we consider potential cost to consumers an essential factor in the Board's net benefits determination under 12 U.S.C. § 1843(c)(8)." Independent Ins. Agents of America, Inc. v. Board of Governors of the Federal Reserve System, 658 F.2d 571, 576, fn. 7 (8th Cir. 1981).

of the automated execution services offered by various exchanges, further challenges will face it as it expands. Competitive pressures have led [sic] numerous brokerage firms, including the large SIA member firms, to rely increasingly on these automated systems (Biller Tr. at 313; BAC Exh. 80 [Affidavit of E.F. Hutton] at ¶ 4; BAC Exh. 82 [Affidavit of Merrill lynch [sic]] at ¶ 4; BAC Exh. 83 [Affidavit of Bache Halsey] at ¶ 4).

There is every reason to believe that adequate capital assistance from BAC will materially aid Schwab in remaining a leader in the adoption and development of new technologies, which will in turn benefit the public by reducing costs, reducing error rates, and increasing the speed with which transactions can be consummated and confirmed. Even though Schwab has been successful in the past in adapting new technologies, these technologies change rapidly and will be very expensive (Stupski Tr. at 72). Expansion from Schwab's present base may be more difficult and more expensive than in the past when Schwab was smaller. BAC can provide the management, technical and capital support that will assist Schwab in its continued growth and innovative efforts. This will provide still further benefits, as Schwab's competitive efforts elicit competitive responses from other firms in the industry.

E. *Increased Competition to Provide Financial Services Packages*

The acquisition will increase competition to provide new packages of financial services. Competition among all financial institutions has increased and has focused on providing consumers with attractive packages of financial services that cut across traditional industry lines. Limitations on interest that can be paid by banks nd savings and loan associations have contributed to the success of money market mutual funds in attracting funds away from banks. With the introduction of Merrill Lynch's Cash Management Account, a new type of package of attractive financial transaction services—including

a traditional brokerage margin account, the provision for market rates of return on available cash balances pending further investment, check writing privileges, a debit card, and other features—became available. Many major brokerage firms and banks have begun or planned to offer similar packages of services to their customers (F. 57-63).

The competitive impact of the proposed acquisition will have an effect on this larger market. With the offering of packages of services which combine brokerage accounts with transactional services such as checking and debit card account access, brokers have succeeded in winning customers away from banks. BAC, through its acquisition of Schwab, can complete to win back customers who have transferred their business from the Bank because of the convenience of the services offered by other financial institutions, and to win new customers by offering new attractive and convenient services. This effort will increase competition.

The mere filing of BAC's application to acquire Schwab has apparently already had some pro-competitive effects. Shortly after BAC's announcement of its plan, Security Pacific National Bank (a major California competitor of Bank of America) announced a joint venture program whereby it began to offer brokerage services to its customers (F. 42, 43). It can be anticipated that many other commercial banks, as well as savings banks and savings and loan associations, will follow suit, which can onlyenhance [sic] competition in the overall financial market.

F. *Increased Convenience*

The acquisition is likely to provide Bank of America customers with convenient brokerage services and Schwab customers with convenient banking services. A test program that holds promise for beginning this process is already under way, with the introduction of Schwab kiosks in Bank of America branches. BAC's support will also help Schwab accelerate its plans to make its services more available by expansion both in

this country and abroad. Technological growth and improvement should mean better customer service in the long run. Development of new packages of financial services also portends increased convenience to the consumer, since new combinations succeed only by offering greater value.

The offering of financial services packages and cross selling offer increased conveniences to customers. SIA members confirm that financial services packages offer more convenience to customers—they enable the creation of "better value and more convenience to the customers" (BAC Exh. 80 [Affidavit of E.F. Hutton]). "The ability to offer more than one product or service to the same customer creates possibilities for efficiencies and provide better value and more convenience to the customer" (BAC Exh. 87 [Affidavit of Dean Witter]).

Cross selling of products eliminates search costs for consumers who are able to purchase two products or services from the same supplier. BAC anticipates that its cross selling efforts will result in several thousand Schwab customers electing to become Bank customers (F. 103). This cross selling effort will be successful only if BAC can offer a better value and more convenience to such customers. BAC anticipates the cross selling effort will be successful, and so does SIA.

G. *Increased Efficiencies*

Many of the increased efficiencies that are likely to result from the acquisition have already been discussed and will be directly reflected in increased competition and in the offering of more convenient combinations of financial services to customers. In addition, the acquisition will lead to the sharing of management and other resources and to the direct financing of Schwab by BAC which will result in "efficiencies" in the sense that fewer resources will be used to produce the same goods.[15]

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15 With respect to the substantial potential for the sharing of computer resources, Mr. McLin, a BAC Senior Vice President, noted that "the bank basicially [sic] has idle capacity in their computer system at the time when Schwab is most busy and vice versa." (McLin Tr. at 35).

The convenience of cross selling to the customer also has efficiencies for the seller in both time and cost. This has been recognized by SIA members:

> "[C]ombinations of [financial] services create possibilities for substantial efficiencies in the use of the Company's facilities and assets, in marketing, and in the development of products which are themselves more efficient to administer. The Company believes that the offering of these multiple services is beneficial both to the company and to the public . . ." (BAC Exh. 80 [Affidavit of E.F. Hutton]; *see also* BAC Exhs. 81-83, 87).

IV. *No Significant Adverse Consequences Are Likely to Result From the Acquisition*

A. *The Alleged Adverse Consequences*

Section 4(c)(8) of the Bank Holding Company Act provides, in applicable part, that the Board should consider whether reasonably expected public benefits

> " . . . outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices." 12 U.S.C. 1843(c)(8).

In its protest filed with the Board, SIA claimed that the competitive effects of BAC's acquisition of Schwab "should be gauged in the submarket for discount brokerage services" apparently based on claims of elimination of BAC as a "potential competitor" or "entrenchment" of Schwab as the largest discount broker (SIA Protest at 27). During the hearings herein SIA shifted its ground and apparently abandoned any claim of anticompetitive effects in the brokerage industry,[16] and instead

16 SIA does propose findings to the effect that the acquisition will put other discount brokers at a competitive disadvantage to Schwab unless they become affiliated with a major bank, and failing this will be forced out of the market (SIA Proposed

raised claims of a probable lessening of competition among banks headquartered in California. Although not asserting any adverse effect on competition in the securities industry, SIA does claim that competitors may be adversely affected by "unfair" competition that may result from the acquisition. SIA also argues that if BAC is permitted to enter the brokerage field, it should be by *de novo* entry.

SIA's contentions of the adverse consequences of the acquisition are: (1) Schwab will have available an artifically [sic] low cost of capital; (2) BAC will have an incentive to price Schwab's services below cost; (3) Schwab will have unfair use of certain Bank privileges; (4) voluntary tie-ins between Schwab services and Bank services; (5) possible conflicts of interest by the Bank; (6) customer confusion; and (7) risks associated with Schwab's business.

B. *Competitive Effect in the California Banking Market*

There are 308 banks in California, thirteen have resources in excess of $1 billion, and five have resources in excess of $10 billion. As of December 31, 1981, the five largest California banks accounted for over 74% of all domestic deposits (40 [sic] firm concentration = 66%, [sic] and 76% of all domestic loans (4-firm concentration = 68% in California banks [sic].

The Bank, the largest bank in the United States and the dominant bank in California, had California domestic deposits, as of 1981, totalling $51,944 million. This represents 35.87% of all bank deposits in California. Although illustrative of the Banks [sic] relative size as compared to other California commercial banks, banking concentration does not fully reflect the alternative sources available to the public for

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Findings 327-328). If discount brokers are forced out of the market, it will be because they cannot offer the attractive combination of products and services which banks will be able to offer. Additionally, the Board's concern should be directed at competition, not competitors. (*see* BankAmerica Corporation (Decimus), 66 Fed. Res. Bull. 511, 515 (1980).

all the different banking services in a local market.[17] For example, when savings and loan association deposits are added to bank deposits, the Bank's share of total deposits becomes 20.27% (F. 95, 96).

Recent developments in financial services have significantly eroded the uniqueness of the products that commercial banks can offer. For example, in offering deposit services, California commercial banks compete with savings and loan associations and credit unions in California and with money market funds available nationwide. In making mortgage loans, California commercial banks compete with savings and loan associations, mortgage bankers, insurance companies, and a variety of other lenders located both inside and outside of California. In making consumer loans, California commercial banks compete with savings and loan associations, finance companies, credit unions, retail merchants, and a variety of other lenders in California, as well as with banks and other institutions located outside of California. In making business loans, California commercial banks compete with out-of-state bank loan production offices, savings and loan associations, finance companies, insurance companies, money market funds and other institutional purchasers of commercial paper, and a variety of other lenders (F. 97).[18]

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17 Herfindahl indices based on total bank deposits in California by SMSA, and total bank deposits and savings and loan association deposits combined by SMSA, have been calculated (F. 101, 102).

18 In connection with research for a book published in 1979, Professor Mussa, SIA's expert witness, made a study of competition among commercial banks and concluded that:

> "In the loan markets, where banks 'sell' credit, they compete on a local, national, and international basis with other banks, with nonbank financial institutions, and with direct credit market instruments. There can be little doubt that these credit markets are highly competitive." (BAC Exh. 75 at 135 [Mussa & R. Kormendi, The Taxation of Municipal Bonds: An Economic Appraisal (1979)]).

An explicit rationale of BAC for the proposed acquisition of Schwab is its desire to expand the Bank's customer base. It is hoped that present Schwab customers in California will move their banking deposits to the Bank thereby increasing its deposit base. BAC estimates, and SIA agrees, it may reasonably expect to acquire 15,000 California customers from its association with Schwab. With an estimated gain in deposits of $10,000 per new customer, an overall increase in Bank deposits of $150 million can be anticipated, which represents an overall gain of approximately three-tenths of one percent of the Bank's total deposits (F. 103).

Undue concentration of resources is specifically mentioned in the statute as a possible adverse effect of a bank holding company affiliate activity (12 U.S.C. 1843(c)(8). The court, in *Ala. Ass'n of Ins. Agents v. Board of Governors of the Federal Reserve System*, concluded that apparently ". . . Congress believed that concentration of economic resources in a single entity beyond a certain point was harmful regardless of the proven existence of any anticompetitive effects of such concentration." 533 F.2d 224, 251 (5th Cir. 1976) From this it is gathered that proof of undue concentration of resources is an adverse effect, without the necessity of proof of actual anticompetitive effect. The determination of what is "undue" concentration of resources was primarily committed to the Board by Congress. *Ibid.*

Here SIA's challenge is not to any undue concentration of resources in the brokerage industry where the acquisition if [sic] being made, but undue concentration of resources in banking in California. The substantial concentration of resources held by the Bank cannot be denied. However, it is the additional resources to be added to the Bank's existing resources that is the concern of this proceeding, and that addition is *de minimus*, i.e., three-tenths of one percent of the Bank's total deposits.[19] It is also relevant to note that this

19 No court or agency has ever found, even as to a horizontal merger which eliminated an existing competitor, that an ex-

prospective increase in the Bank's deposits, the concern of SIA, is not by virtue of the acquisition itself, but because of gains expected to be realized through cross selling—the offering of a better and more convenient product to consumers.

Although not made an issue by SIA, the resulting increase in BAC's equity capital by reason of the acquisition of Schwab would also amount to only three-tenths of one percent (Schwab's stockholder equity is $12 million versus BAC's equity capital of $4,091 million—F.3, 10).

Because of the Bank's dominant position in the California market, any potential increase in the Bank's market power is cause for concern, and must be considered an adverse effect in the overall net "public benefits" test.

C. *Capital Cost Advantage to Schwab*

SIA contends that Schwab will enjoy an artificially low capital cost by virtue of its acquisition by BAC. This alleged advantage arises from the contention that banks and other depository institutions are effectively guaranteed against any significant risk of loss by government agencies, and those who control lendable funds are willing to lend those funds to large commercial banks on more attractive terms because of the lower risk attendant on such loans (SIA Proposed Findings 216-223).

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pected increase in a market share of only 3/10th of one percent would have an adverse effect on competition; and the Federal Reserve Board has expressly concluded that increases of such a small amount would be inconsequential. *See, e.g.,* FTC v. Tenneco, Inc., 433 F. Supp. 105 (D.D.C. 1977) (holding that 0.3% market shares was *de minimis*); Warner-Lambert Co., 87 F.T.C. 812, 904 (1976) (holding market shares of 0.1% and 0.2% *de minimis*). Greater New Jersey Bancorp., 68 Fed. Res. Bull. 239 (1982); National City Corp., 67 Fed. Res. Bull. 52 (1980) (0.1% *de minimis*); Central Bancshares, Inc., 64 Fed. Res. Bull. 674 (1978); National Bancshares Corp., 64 Fed. Res. Bull. 887 (1978) (0.1%); Marine Corp., 63 Fed. Res. Bull. 1090 (1977) (0.4%) increase.

It is common practice for parent companies to provide money to their subsidiaries in the form of equity capital and loans in order to meet the funding requirements of the subsidiaries. An acquired company which is funded by its parent may experience lower funding costs after the acquisition for several reasons, including the strengthening of the subsidiaries' economic potential and lessening of its risk as part of a larger enterprise, and on account of efficiencies with respect to transaction costs and evaluation of the risks which the subsidiary faces (F. 87). SIA apparently does not challenge these efficiencies, but is concerned about an artifically [sic](based on the bank's credit rating) low cost of capital.

Banking laws restrict lending by a bank to its parent holding company and to that holding company's non-banking subsidiaries so severely as to make such lending impracticable. Thus, BAC, not the bank, is the source of funding for its non-banking subsidiaries. BAC will be able to provide capital to Schwab in a manner more efficient and at Iower [sic] cost than the alternatives available to Schwab were it to enter the capital markets directly (F. 89).

The record evidence supports a conclusion that bank holding companies in general and BAC in particular, do not raise money at lower rates than other Iarge [sic] firms. In fact, bank holding companies incur somewhat higher marginal costs for short, medium, and long-term funds as compared to large industrial and non-bank related financial firms (Kimmell Rebuttal at 4). The testimony and affidavits of officials of BAC, Merrill Lynch and Bache Halsey Stuart (brokerage subsidiary of Prudential), show that the commercial paper rates of BAC were, if anything, slightly higher than the commercial paper rates of Merrill Lynch, Sears, and Prudential for the period May through July of 1982. Statistics published by the Federal Reserve Board indicate that BAC's commercial paper rates during the period May through July 1982 were generally the same or higher than both the rates on commercial paper placed

for other firms whose bond rating is AA or the equivalent and the rates on commercial paper of firms which placed their commercial paper directly (F. 94). In *Automobile Leasing As an Activity for Bank Holding Companies*, 62 Fed. Res. Bull. 930, 936 (1976), the Board found that large independent firms in the automobile leasing business have approximately the same borrowing costs as bank holding companies and that any cost disparities in the case of smaller independent firms are based principally on relative size. On that basis, the Board concluded that automobile leasing subsidiaries of bank holding companies would not have an "unfair" competitive advantage on account of their access to low cost funds.

In enacting the Bank Holding Company Act of 1956, and again when it amended the Act in 1970, Congress expressly recognized that public benefits—not detriments—flow from the ability of bank holding company subsidiaries to borrow money from their parent companies. Indeed, the Senate Committee recommending passage of the initial legislation expressly rejected the suggestion that bank holding company subsidiaries be required to obtain funds from sources other than their parents. As the committee reported in 1955:

> "The bill does not prohibit the borrowing of funds by any subsidiary in the system from the parent bank holding company. *Such downstream financing is one of the beneficial advantages cited to your committee in the use of the bank holding system technique*. Downstream financing enables the bank holding company to draw on the equity capital of its shareholders and its own operating funds in order to strengthen the financial condition of any one or more of its subsidiaries."

S. Rep. No. 1095, 84th Cong., 1st Sess. 15 (1955) (emphasis added). Consistent with Congress' view, the Board has repeatedly recognized that public benefits—not adverse consequences—flow from the ability of a bank holding company to

provide funds to an acquired company at a lower cost than the acquired company otherwise could obtain.[20]

BAC in the past has used formulas for setting short and long-term rates to be used in making loans to affiliates (F. 90-91). The short-term is the average commercial paper rate paid by ten top-rated firms (not including BAC or the Bank). The formula for the long-term rate assumes that funds supplied by BAC and used by the subsidiary were acquired in equal monthly amounts over the preceding 60 months and a "composite," or "pool" rate is then calculated. Since over the past 60 months interest rates have risen in a considerable amount, the "pool" rate based on the earlier years was much less than the going market rates exisiting [sic] during much of the period 1980-1982. Thus, it appears that the long-term pool rate provided BAC affiliates an unusually low cost of capital during recent years.[21] However, if interest rates tend lower, which they have over the last few months, BAC's "pool" rates based on the high rates prevailing in 1980-82 will exceed the going market rate.

The charges to BAC's subsidiaries are designed to and do reasonably approximate BAC's own cost of funds.[22] BAC

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20 *E.g.*, Manufacturers Hanover Corp., 66 Fed. Res. Bull. 599, 600 (1980); Bank of New York Co. [sic] 66 Fed. Res. Bull. 793, 794 (1980); Mellon National Corp., 62 Fed. Res. Bull. 702, 707, 708, 721 (1976); Security Pacific Corp., 62 Fed. Res. Bull. 634, 635 (1976); Depositors Corp., 60 Fed. Res. Bull. 312 (1974); First Virginia Bankshares Corp., 59 Fed. Res. Bull. 202, 203 (1973).

21 For example, the long-term pool rate for five year money in 1981 averaged ten percent (Mussa Direct at 17). Yet, in 1981, BAC borrowed $250 million for eight years at 16¼ percent (BAC Exh. 2 at 40).

22 The parties argue at length about BAC's marginal cost of funds. The marginal cost of funds is, by definition, the cost of

would have no incentive to provide funds to Schwab unless it could expect to receive a return equal to the marginal cost to it of making these funds available, including an appropriate return for the risk incurred. Thus, it does not appear that Schwab will have an artificially low cost of capital. While BAC will be able to provide Schwab capital funds at a lower cost than Schwab could obtain on its own, this is an inherent advantage of the acquisition, a public benefit and not an adverse consequence.

D. *BAC's Alleged Subsidy of Schwab's Services*

As previously noted, BAC intends to expand its total customer base by cross selling bank services to Schwab customers. BAC regards cross selling of brokerage services to bank customers and bank services to brokerage customers an important aspect of the Schwab acquisition (F. 103, 122). Since banks earn greater than normal profits from the sale of certain banking services, such as on deposits with regulated interest ceilings and with Iow [sic] service costs relative to average balances, banks spend money to try to induce customers to deposit money into savings accounts on which the interest rate is regulated.

BAC expects to be able to cross-sell the Bank's services to Schwab's upscale customer base. BAC estimates that each additional California customer of the Bank who has the same financial characteristics as Schwab customers may be expected to add $150.00 per year to the Bank's before-tax earnings while each non-California customer will add $30 per year. BAC estimates that acquisition of Schwab will result in adding more than 15,000 additional California customers and 70,000 additional non-California customers to the bank and increasing

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borrowing the last dollar. Instead os [sic] using its marginal cost of funds in making loans to affiliates, BAC uses formulas consisting of its *average* cost of funds over a period of time. These averages fairly reflect BAC's actual cost of funds.

BAC's annual profits by $4.7 million (F. 122). Thus, SIA contends BAC would be willing to subsidize Schwab to the extent of $4.7 million to retain or expand Schwab's existing customer base (SIA Proposed Finding 277).

None of the numerous acquisition documents in the record even suggests that BAC would embark on such a course of action. BAC's plans call for the Bank to gain Bank deposits from cross selling Schwab services, not from any subsidy of Schwab's commission rates. Thus, the gain would come from convenience and efficiencies. In fact, BAC has an expectation that each affiliate will return 15 percent on equity capital. BAC will not invest in Schwab unless it can anticipate an attractive long-term return on investment comparable to alternative uses available for BAC funds (Prussia Direct at 8). Further, any subsidization of Schwab services would offset any gains to the Bank from the practice, making subsidization largely self defeating.[23]

While there are incentives present for subsidization, such practice is usually found where the recoupment of losses is expected to be gained in the same line of business at a later date. *See*, Areeda & Turner, *III Antitrust* ¶ 711b, at 151-52. There is no contention tht BAC would recoup its alleged subsidization losses in the brokerage market at some future date.

It is concluded that there is no credible evidence that subsidization is likely to occur or that any substantial adverse effects can be anticipated from such a practice.

E. *Alleged Unfair Use of Bank Privileges*

The Bank serves as an underwriter of certain general obligation municipal bonds, and it maintains a trading inventory of $135 million of such securities. The Bank is the predominant bank underwriter and dealer in municipal bonds in California. Municipal bonds are not traded on exchanges and must be

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23 *See* BAC Posthearing Brief, pp. 68-70.

purchased (or sold) through dealers who carry such bonds (F. 82).

Under the Munimart arrangement, developed after the announcement of BAC's proposed acquisition of Schwab, Schwab carries out orders for municipal bonds for its customers by obtaining a quote from the Bank on the desired bond. If the Bank does not possess the precise bond requested by Schwab's customer, then the Bank will offer quotes on similar bonds in its inventory, which quote the Schwab employee will pass on to the customer. If the customer agrees to make the purchase after learning of the bond's availability, Schwab will buy the bond from the Bank's bond department for immediate resale to the customer. In only about half the bond transactions it carries out do Schwab customers specify the particular bond desired (F. 83).

Banks have a special tax privilege allowing them to deduct the entire carrying costs for their inventories of municipal bonds in determining their federal tax liabilities. The IRS does not permit broker-dealers who hold inventories of tax-exempt municipal bonds to deduct interest paid on that fraction of their debt that is assigned to the carrying of municipal bonds. Therefore, commercial banks that operate as traders of municipal bonds have a significant tax advantage relative to securities dealers that trade the securities. The Bank would realize this tax advantage on the bonds out of inventory which are sold through the Munimart arrangement with Schwab (F. 85).

Bank holds in inventory municipal bonds which it sells to other brokers and dealers at the same price at which it sells to Schwab. The Bank and other dealer banks and broker/dealers advertise in the blue list the bonds in their inventory which they wish to sell through the same, nationwide medium. There is no reason to believe that Schwab will receive any artificial advantage as compared to other firms that buy municipal bonds from the inventories of the Bank, dealer banks, and broker/dealers. The Munimart arrangement between BAC and Schwab at most presents an opportunity for the Bank to sell some

municipal securities to Schwab customers that it might not otherwise sell through its underwritings. This is a matter of cross selling and efficiencies of being an affiliate. Schwab receives no better price from the Bank than other broker/dealers. The tax advantage to the Bank exists as a matter of law and acquisition of Schwab will not change this advantage in any significant respect.

F. *Voluntary Tie-Ins*

SIA contends that the acquisition of Schwab by BAC presents a threat of voluntary tie-ins. A voluntary tie-in occurs when a customer believes that he or she would have a better chance of obtaining a certain restricted product from a company if the customer purchased another product from the same company and the customer actually does purchase that other product because of this belief. Where a concern's market power is visible to the individuals who are dependent upon the services or products of a particular enterprise, individuals will voluntarily purchase other products from the same enterprise in the hope that it will increase their opportunities of purchasing the desired product (SIA Proposed Findings 329-330).

Joint purchases—that is, purchasing two different goods or services from the same supplier at the same time—occur frequently in most product markets. In fact, millions of joint purchases occur because the potential search costs for the second good or service often exceed the potential savings for the customer from splitting the joint purchase into separate transactions. The joint purchase made by the customer entirely voluntarily in his best interest cannot be considered a tied sale. It is also quite clear that a supplier may explicitly demand that anyone buying a product or service also purchase another service as a condition of supplying the first one. This latter type of coercive tying is illegal under Section 106 of the Bank Holding Company Act, and has not been made an issue by SIA (F. 105).

Between the two extremes of explicitly coercive tied sales and purely voluntary joint purchases, a wide variety of tied sales may occur. They may range from a situation that is characterized by strong "implicit" pressure by the supplier on the customer to make the tied purchase, to a mere suggestion of the seller to the buyer that it might be to his advantage to make the joint purchase. The degree to which these pressures are exerted successfully, or are correctly perceived by the buyer, depends importantly on the market power of the supplier. "[T]he dangers of 'voluntary' tie-ins and reciprocity are basically structural." Conference Report, 1970 U.S. Code, Cong. & Adm. News at p. 5569, cited in *Ala. Ass'n. of Ins. Agents v. Board of Governors of the Federal Reserve System*, 533 F.2d 224, 250 (5th Cir. 1976). Whenever an appreciable degree of implicit pressure exists, a joint purchase is no longer purely voluntary because a consumer's decision is influenced or constrained to some extent by the presence of market power in the tying market. On the other hand, a consumer may choose to buy more than one product or service from the same source on the assumption that as a regular customer he will receive a more personal service or some benefit in the future. To force the purchaser to choose their second best alternative would deprive the public of their maximum satisfaction and potential search savings (F. 106).

Recent developments in financial services have significantly eroded the uniqueness of the products that commercial banks can offer so that banking concentration does not fully reflect the alternative sources available to the public for all the different banking services in a local market. Many alternative bank and non-bank sources of credit exist for locally limited customers (small businesses and consumers) that few borrowers could objectively conclude that any potential coercion or potential retribution exists if the two purchases are made separately. In competitive markets it is far more likely that borrowers judge the joint purchase to be both more convenient

and more economical, resulting in some cases in a high proportion of joint purchases.

An important objective of the Bank's marketing program is the cross selling of its services to present and prospective Schwab customers. BAC, in fact, anticipates that it will gain a substantial number of Schwab customers as Bank customers (*see* F. 103, 108, 122). Cross selling is beneficial to consumers because it (1) lowers consumer search costs; (2) lowers the cost (and thus the price) of goods and services as a result of efficiencies of joint production and sale, and (3) increases the value of goods and services as a result of economies of joint purchase and consumption. BAC and its subsidiaries attempt to find cross selling opportunities as a way of lowering their costs and increasing the value of the services they provide. Securities brokerage firms, particularly full-line brokerage firms, also engage extensively in cross selling. They regard it as important to offer their customers a variety of financial services and products, including those of their affiliates which offer opportunities for cross selling (F. 110). To the extent that BAC's acquisition of Schwab results in cross selling packages of financial services to Schwab and Bank customers, the result will be added competition and convenience for customers.

SIA acknowledges that Schwab's customers are "upscale retail banking customers," knowledgeable about their investments (SIA Proposed Findings 311, 95). Under the circumstances, these individuals are less likely to be implicitly coerced into purchasing a product or service not independently desired. While there is a possibility that some purchases will be made that are not truly voluntary, the benefits gained by eleminating [sic] those few transactions would be at the expense of the substantial number of truly joint purchases made on the basis of cost savings and convenience, real or imagined. Thus, the dangers of potential tie-ins have not been shown to outweigh the public benefits from cross selling.

G. *Conflicts of Interest, Public Confusion, and Risks of Schwab's Brokerage Business*

1. *Conflicts of Interest*

SIA contends that BAC's interest in maximizing the profitability of the company's subsidiaries as a whole may result in pressure being applied to the banking affiliate to take into consideration the interests of the larger unity when considering a loan application. When a loan applicant is a customer or potential customer of an affiliated subsidiary, the parent will have an interest in insuring that the customer obtains the loan in order to retain or increase the business of the affiliate and maximize the profitability of the company's subsidiaries as a whole. This could result in a conflict of interest in underwriting the loan application since a bank owes a duty to its depositors to evaluate a loan application soley on the basis of whether the loan would provide an adequate rate of return in light of the repayment risk. (SIA Proposed Findings 345-347).

A further conflict may arise in BAC's selection of a broker for its fiduciary trust accounts. BAC will have an incentive to process its trust department securities transactions through Schwab (SIA Proposed Findings 348-353).

Schwab performs brokerage services of a type which the Bank uses as a fiduciary of trust accounts. The fiduciary duty owed the Bank's trust account customers and BAC's economic interest in using Schwab to process the trust account orders also constitutes a potential conflict of interest resulting from the acquisition.

Soundness of bank practices is a primary purpose of regulatory supervision of banks, and the loans made by the Bank are subject to periodic review by federal examiners. The Bank employs strict internal standards and safeguards to prevent unsound loans. Federal laws and regulations impose a duty on the Bank to choose brokerage services upon the basis of "best execution." Trust departments are closely examined by federal regulators and Schwab, in addition, is regulated by the rules

and regulations of the SEC and the various exchanges (*see* 12 U.S.C. §§ 371(c), 375(b), and 12 CFR § 9.5). In addition, the Bank would be subject to suit for failure of its fiduciary responsibilities. BAC has established procedures for its trust department to insure that it fulfills its fiduciary responsibilities. There is no record evidence that BAC has, or will, engage in conflicts of interest that will cause undue consumer harm or injure competition.

Members of SIA (including their affiliates) sometimes have multiple interests in dealing with a customer. To the extent that such multiple interests give rise to potential conflicts of interests, these customers are protected both by law and by internal controls of these firms. SIA members regard applicable legal requirements as sufficient to protect their customers' interests. There is no evidence that the acquisition of Schwab by BAC would give rise to any conflicts of interest different in character or magnitude from those which broker/dealers and their affiliates experience.

2. *Public Confusion*

SIA argues that the marketing plans which BAC proposes to use with its Schwab affiliates, such as the logo "A BankAmerica Financial Services Company," the establishment of a division of Schwab called "Bank Brokerage Services," the placement of Schwab kiosks in Bank branches, and allowing Bank customers to use a Bank checking or savings account as a payment mechanism for a Schwab brokerage account, will lead customers to believe that BAC's and the Bank's financial resources stand behind Schwab in some manner. According to an expert witness for SIA, customers will believe that the Bank's financial resources stand behind Schwab in some manner and not appreciate that "BankAmerica" refers to the holding company and not the Bank (Mendelson Direct at 9-10; Mendelson Tr. at 1094). Presumably this public perception is not in accordance with the facts (SIA Proposed Findings 354-364).

BAC's present marketing plans for Schwab do not misrepresent any aspect of Schwab's affiliation with BAC or the Bank. Under the kiosk project the service will be identified to customers as "Stock Brokerage Services . . . Provided by Charles Schwab & Co., Inc." Customers wishing to place orders will deal directly with Schwab (McLin Rebuttal at 2-4). While the precise liability of the Bank for the obligations of Schwab may not be fully comprehended by customers (although the Schwab customer base consists of "Upscale" retail banking customers who have average incomes of about $60,000 per year—SIA Proposed Finding 311, and are knowledgeable concerning their investment alternatives—SIA Proposed Finding 95), Schwab actually will be in a stronger financial and management position after its acquisition by BAC than before the acquisition (F. 77, 78, 80).

While SIA has not made clear which members of the public will be harmed, the Bank's customers or Schwab's customers, all such customer accounts are subject to governmental regulation and are insured. Thus, there is little liklihood [sic] that public confusion about the nature of the relationship between the Bank and Schwab will occur, or that any limited confusion on the part of the public will cause any undue harm.

3. *Risks of Schwab's Brokerage Business*

SIA states that the brokerage industry is a high-risk industry subject to substantial and unpredictable fluctuations, and that discount brokerage is particularly subject to high risks because of large swings in the volume of securities trading and the relative rigidity of costs. The association together of Schwab and the Bank in the public's mind would cause a public loss of confidence in the Bank if Schwab failed as a business enterprise. Thus, the Bank would have an incentive to shore up Schwab through unsound loans or other measures inconsistent with sound banking practices to the detriment of Bank depositors (SIA Proposed Findings 365-380).

While the record establishes that the earnings of discount brokers has widely fluctuated, the brokers have been profitable (SIA Proposed Finding 367; Mendelson Direct at 12; BAC Exh. 19 at 9; F. 30, 31). Further, Schwab has been quite profitable (F. 11), and does not deal in or underwrite securities, the higher risk activities of brokers. It taxes credulity to assert that Schwab is likely to suffer, or BAC permit Schwab to sustain, financial reverses of such a magnitude that the Bank or its depositors would be jeopardized.

H. *De Novo Entry Should Not Be Required*

SIA contends that *de novo* entry by BAC would be more procompetitive than the acquisition of Schwab, and should be required if BAC desires to enter the brokerage industry (SIA Proposed Findings 381-387; SIA Reply Brief at 43-45). BAC unquestionably has the financial resources and technical experience to expand it [sic] present brokerage activities *de novo*, and such entry would not eliminate Schwab as an independent competitor, but would add a new competitor. *De novo* entry by BAC would also eliminate any additional profits BAC might make from cross selling Schwab customers, and the possible enhancement of Bank deposits.

Congress has provided in Section 4(c)(8), that:

> "In orders and regulations under this subsection, the Board may differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern." 12 U.S.C. § 1843(c)(8) (1976).

"[W]here a bank holding company enters a new market *de novo*, or through acquisition of a small firm, as opposed to acquisition of a substantial competitor, its desire to succeed in its new endeavor is more likely to be competitive." H.R. Rep. No. 91-1747, 91st Cong., 2d Sess. 17-18 (1980) (conference report); *Ala. Ass'n. of Ins. Agents v. Board of Governors of the Federal Reserve System*, 533 F.2d 244, 249 (5th Cir. 1976).

While Congress clearly believed that an activity commenced *de novo* is likely to be more competitive than the acquisition of a substantial competitor, there is nothing in the legislative history, or in court or Board decisions, that mandates *de novo* entry by bank holding companies into new activities. Clearly, each proposed acquisition must be evaluated on its own under the statutory net "public benefits" and "adverse consequences" test. If a proposed acquisition passes the statutory test, the Board is authorized to approve it even though *de novo* entry might be more competitive.

Twelve U.S.C. § 1843(c)(8) indicates a wide range of factors to be considered by the Board when reviewing a non-bank acquisition. Unlike the provision governing Board approval of bank acquisitions, the statute does not articulate a specific antitrust standard for the Board to observe, although the statute does make adverse competitive effects a major consideration in connection with non-bank acquisitions. Whatever the exact contours of the balancing to be done, it appears that the Board would be constrained to disapprove an acquisition that would violate the antitrust laws. *See Whitney Nat'l Bank v. Bank of New Orleans,* 379 U.S. 411, 419 (1965). Further, it seems reasonable for the Board generally to be guided by antitrust principles in evaluating the competitive effects of any merger or acquisition. *Cf. County National Bancorp. v. Board of Governors of the Federal Reserve System,* 654 F.2d 1253 (8th Cir. 1981); *Mercantile Texas Corp. v. Board of Governors of the Federal Reserve System,* 638 F.2d 1255 (5th Cir. 1981). Thus, general antitrust principles developed for sound merger analysis are helpful to a focused and coherent inquiry into the potential competitive effects of BAC's proposed acquisition of Schwab.

An antitrust analysis first requires identification of relevant product and geographic markets. Definition of a relevant product market involves a determination of which product offerings are reasonably interchangeable as a matter of practi-

cal function and use[24] with the product provided by Schwab—retail securities brokerage. Two products should be placed in the same product market if commercial realities indicate that they present consumers with reasonably substitutable choices.[25] This test leads to the conclusion that the relevant product market is all securities brokerage provided to retail customers.

There is no apparent dispute that execution of securities trades on a stock exchange or in the over-the-counter market is a unique product. The only real product definition question raised in this proceeding is whether "discount brokerage" is a separate market from "full-line" brokerage services (*see* SIA Opposition Memorandum [May 28, 1982] at 27; *cf.* Mussa Tr. 888).

There is great variation among brokerage firms in terms of price structure and the range of services offered to customers. Some discounters offer investment advice and investment opportunities in addition to basic execution services, while many full-line firms offer discounts in order to retain large, active retail customers. However, "discount brokerage" does not define a discrete product market; it merely describes an important competitive response by a number of firms in offering the basic retail brokerage product. Discount brokers are simply those firms that advertise and charge commissions to all their customers which are substantially lower than the commissions in effect before May 1975 (when competitive pricing of retail commissions was first permitted).

Discount brokers and full commission brokers compete for the same transaction execution business of the same retail customers. Discount brokers choose to emphasize price while

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24 United States v. E.I. duPont de Nemours & Co, [sic] 351 U.S. 377, 395 (1956); *see* Department of Justice Merger Guidelines, par. II. A, (June 14, 1982 ("Merger Guidelines").[sic]

25 United States v. Aluminum Co. of America, 377 U.S. 271, 273-77 (1964).

full-line firms generally emphasize personal service. Discounts vary by both full-service and discount brokers, depending upon the type of customer and volume of trade (F. 26-29). The services offered by full-line brokers and discount brokers are reasonable supply substitutes.

Consumers also view the services offered by full-line and discount brokers as substitutes, a fact illustrated by evidence of record. Statistics show that many of Schwab's new customers are gained at the expense of full-line brokers while Schwab also lost many customers to these other brokers (Stupski Direct at ¶ 44; Biller Direct at 45). Indeed, even SIA's witnesses agreed that the basic service every broker provides is execution of the consumer's securities trades (Jannotta Rebuttal at 11). "[T]here are substantial similarities between what Schwab does and what national full line retail firms do." *Id.* at 3-4; Mussa Rebuttal at 17; Mussa Cross at 857. Dr. Mussa, SIA's expert economist, conceded that the relevant product market was all retail securities brokerage. Mussa Cross at 888; *accord.*, Baxter Cross at 437-38.

Further, discount brokerage does not constitute a submarket under the criteria for determining the existence of submarkets, enumerated by the Supreme Court in *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962). The product, discount brokerage, has no peculiar characteristics and uses, no unique production facilities, no distinct customers, no distinct prices, or sensitivity to price changes. It is debatable whether there are specialized vendors or industry recognition of discount brokers as a separate economic unit.[26] There is no clear, distinct separation between full-line brokers and discount brokers; the products and services they offer are interchangeable to a substantial degree.

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26 The SEC, in developing industry statistics, lists discount brokers with New York Stock Exchange, regional exchanges, introducing and carrying broker/dealer groups (BAC Exh. 55 at 33).

The proper geographic market in which to measure competition in retail securities brokerage is the entire United States (F. 25). The starting point is where Schwab in fact does business. Schwab's home base is in California, and it has a nationwide network of 51 offices in 26 states and the District of Columbia. While the bulk of Schwab's business comes from the metropolitan areas in which it has offices, it regularly deals with customers outside those areas. Schwab is licensed to conduct business in all fifty states. Its network of offices can be accessed by customers from anywhere in the United States through use of a toll free number (Stupski Direct at ¶¶ 4, 5)—Schwab has 80 toll-free numbers. Indeed, during certain hours Schwab's telephone network automatically switches customer calls between offices[27] with no apparent adverse effect on customer services.

In addition, Schwab, like other securities brokers, offers uniform rates throughout the country and it advertises primarily through nationwide financial publications (Stupski Direct at ¶ 5). Schwab's market is national in scope.

Dr. Baxter, a BAC witness, testified that given the ease of entry by out of area firms into markets and the ease of telephone access to out of area firms, securities brokerage firms compete in a national market (Baxter Cross at 440; *see also* Mussa Tr at 890-91). Thus, the evidence of record supports the conclusion that the market for retail brokerage services is national in scope.

The parties agree that the securities brokerage market is competitive (*see, e.g.*, Mussa Rebuttal at 6, 11-12; Biller Direct at 40; Baxter Direct at 28; F. 25, 26; SIA Proposed Finding 64). Concentration levels are quite low (Mussa Rebuttal at 5-7);

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27 For example, after 5 p.m. eastern standard time a New York City customer might well have his call switched to an open Schwab office in California, where his order would be taken and processed just as though it had been taken by the New York City office. *See* BAC Exh. Stupski—1 at 6.

four-firm concentration level in 1980 was 24% and eight-firm level was 37% (F. 24), and entry into the market is easy (Mussa Rebuttal at 8-9; SIA Proposed Findings 67, 81, 89). Furthermore, in terms of total commission revenues, Schwab's market share is less than one percent. By any conventional analysis, BAC's proposed acquisition of Schwab would not diminish competition in the competitive securities brokerage market.

SIA suggests that BAC is a "potential entrant" into retail brokerage and therefore should be compelled to enter *de novo* rather than by acquisition (Mussa Rebuttal at 45-51 [sic]); SIA Proposed Findings 381-387; SIA Reply Brief 43-45). Substantial concentration of the target market is a critical element that must be established to show that a proposed acquisition would eliminate significant potential competition.[28] This critical element is not present here since the brokerage market is unconcentrated. Moreover, Schwab has a very small share of that market. In addition, there appear to be numerous potential entrants into the brokerage market in the form of banks and savings and loan associations. Elimination of one potential entrant would hardly be significant.

Thus, there is no substantial evidence to support a claim that the proposed acquisition is likely to have a significant adverse effect on overall competition in the securities brokerage market. In fact, the acquisition by a potential entrant of a firm with one percent of the market could be considered a toe-hold acquisition having significant procompetitive effects.

V. *SIA's Requested Restrictions on BAC's Activities*

SIA has made a number of suggestions as to possible restrictions or conditions on BAC's activities (SIA Brief at 118-121). After due consideration it is concluded that none of these restraints should be enforced.

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28 *See, e.g.,* United States v. Marine Bancorporation, 418 U.S. 602, 624-25 (1974); Merger Guidelines, par. IV. A. 3. a.

The restriction considered and the reason for the rejection are:

1. BAC should not be allowed to use its assets or business relationship to finance Schwab's securities activities. As noted earlier in this decision, BAC's financial assistance to Schwab will not provide Schwab unfair competitive advantage vis-a-vis other securities firms. Any possible lowering of the cost of funds to Schwab would be an added benefit to the public. Congress has chosen Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, to regulate financial transactions between banks and nonbank affiliates. No showing has been made that additional safeguards are needed in the instant matter. Further, the Board has repeatedly enunciated the policy and managerial strength for its subsidiaries. *Citicorp. Fidelity Savings and Loan Ass'n.* ____ Fed. Res. Bull. ____ (Press Release dated September 28, 1982).

2. BAC should be prohibited from promoting Schwab as its affiliate causing (confusion to the public as to Schwab's separate corporate status) [sic]. BAC should not be permitted to promote Schwab on the basis of its affiliation with BAC or the Bank, and Schwab should not be permitted to share space with any member of the BAC organization (e.g., Schwab kiosks in Bank branches). As noted earlier, one of the real advantages to allowing the acquisition is the linking of Schwab, a very young, not well-established discount brokerage firm to a well-established bank. BAC will aid in the legitimazation [sic] of discount brokeraging to the benefit of small investors who might otherwise continue to use full-line brokers (*see Citicorp, supra.*)

3. Prohibit Schwab's providing of brokerage services for Bank fiduciary accounts. As noted, no sound reason

for insisting upon this restriction has been advanced since the Bank is already under regulatory and legal obligations with respect to its fiduciary accounts to act only in their best interests. Such a restriction might inhibit certain conveniences, efficiencies and cost savings.

4. Terminate the sale of municipal bonds through the "Munimart" program. As concluded herein, the Munimart arrangement merely presents an opportunity for the Bank to sell some municipal securities to Schwab customers that it might not otherwise sell. Schwab does not receive a better price from the Bank than other broker/dealers. Any real advantage to the Bank was granted by Congress through the Internal Revenue Code. For these reasons, any restrictions placed upon the Munimart program will have no real effect on the Bank's preferred tax status or municipal bonds and will restrain competition in the sale of such securities.

5. Permanently enjoin Schwab from offering investment advice. Schwab does not now nor does it or BAC have plans of offering investment advice to customers in the future (McLin Direct at 9-10). BAC's Application does not request permission to offer investment advice. Therefore, any restriction of such an activity is presently irrelevant.

6. Reasonably prohibit Schwab from underwriting or dealer activity, including the activities presently carried on with the Kemper market fund. It has already been found that the limited underwriting activities carried on by Schwab are a proper incident to its brokerage business, closely related to banking and are to be permitted.

7. BAC should not be permitted to expand its activities by the acquisition of other discount brokerage firms.

Any such acquisition would require Board approval and therefore any discussion of the subject at this time is totally unnecessary and premature.

8. Non-disclosed activities should be disallowed. For the reasons mentioned above any restrictions on activities not presently under consideration would be irrelevant to this decision.

9. BAC should be prohibited from continuing to offer Schwab products and services that are unnecessary to the operation of retail agency brokerage. SIA argues that activities like the offering of "sweep" accounts, and margin lending are unnecessary and unrelated to the proposed brokerage activities. It has been determined herein that such activities are permissable [sic] because they are closely related to banking and/or properly incidental to activities and reasonably necessary to effective carrying on of brokerage activities.

Accordingly, it is recommended that no restrictions be placed upon any of the activities of Schwab for which BAC is seeking Board approval.

SUMMARY

The Glass-Steagall Act, which restricts commercial bank involvement in investment banking, does not prohibit BAC from engaging in brokerage activities through its proposed acquisition of Schwab. The discount brokerage activities in which BAC will participate through its new acquisition, are closely related to banking within the meaning of Section 4(c)(8) of the Bank Holding Company Act, or are incidental activities reasonably necessary to carrying out the closely related activities. Benefits to the public far outweigh any possible adverse consequences that reasonably may be expected. These advantages include increased price competition in securities broker-

age and increased price and service competition in the larger financial services market. Also, increased efficiencies and greater convenience for individual customers can be expected. The restrictions proposed by SIA are to be denied; they are unnecessary, burdensome and would tend to negate the advantages that will otherwise arise out of the acquisition.

RECOMMENDATION

It is recommended that the application by BankAmerica Corporation to acquire The Charles Schwab Corporation and thereby engage in securities brokerage activities be approved.

ERNEST G. BARNES
Ernest G. Barnes
Administrative Law Judge

November 12, 1982

Errata to Recommended Decision of Administrative Law Judge, dated November 12, 1982

UNITED STATES OF AMERICA
BEFORE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

DOCKET NO. R-0398

In the Matter of

Application by BankAmerica Corporation

To Acquire

The Charles Schwab Corporation

ERRATA

The following corrections should be made to the Recommended Decision filed herein today:

(1) Take out the second comma in the next to last [sixth] line on page 108 [84A].

(2) Change the last two [three] lines [of the third paragraph] on page 128 [97A] to read: "(4-firm concentration =66%) and 76% of all domestic loans (4-firm concentration =68%) in California banks."

(3) Change "if" to "is" in last [second] line [of the third paragraph] on page 131 [99A].

(4) Change the last sentence of paragraph numbered 1 on page 161 [119A] to read: "Further, the Board has repeatedly enunciated the policy that a holding company should serve as a source of financial and managerial strength for its subsidiaries."

Errata to Recommended Decision

(5) Change the first sentence of paragraph numbered 2 on page 161 [119A] to read: "BAC should be prohibited from promoting Schwab as its affiliate (causing confusion to the public as to Schwab's separate corporate status)."

ERNEST G. BARNES
Ernest G. Barnes
Administrative Law Judge

November 12, 1982

THE FEDERAL RESERVE SYSTEM

BankAmerica Corporation

Order Approving Acquisition of Retail Discount Brokerage Firm

BankAmerica Corporation, San Francisco, California ("BAC"), a bank holding company within the meaning of the Bank Holding Company Act (the "BHC Act"), has applied for the Board's approval under section 4(c)(8) of the Act (12 U.S.C. § 1843(c)(8)) and section 225.4(b)(2) of the Board's Regulation Y (12 C.F.R. § 225.4(b)(2)) to acquire 100 percent of the voting shares of The Charles Schwab Corporation, San Francisco, California, a company that engages, through its wholly-owned subsidiary, Charles Schwab & Co., Inc. ("Schwab"), in retail discount securities brokerage, extending margin loans, and other incidental activities. None of the proposed activities is among those that the Board has designated in Regulation Y as being closely related to banking and thus permissible for bank holding companies under section 4(c)(8) of the Act.

Notice of the application, affording interested parties an opportunity to submit comments and views, was duly published in the *Federal Register*. In response to its request for comments on this application, the Board received 17 written comments opposing the acquisition, and 82 favoring the acquisition, including comments from the Department of Justice, the Comptroller of the Currency, and the Securities and Exchange Commission. Among the comments opposing the proposal were those of the Securities Industry Association (the "SIA"), a national trade association representing over 540 securities brokers, dealers, and investment banking organizations. The SIA requested that the Board either deny, or order a formal hearing on, BAC's application.

On July 6, 1982, the Board issued an order scheduling a formal public administrative hearing on BAC's proposal. The

Board's hearing order observed that, while the questions raised by the various comments and protests to BAC's application might appropriately be resolved through additional written submissions, a formal hearing would provide an appropriate and expeditious method for developing a full record for Board consideration of any disputed material facts. The Board's order established an expedited briefing and hearing schedule. With the consent of the parties to the hearing, the United States Department of Justice was permitted to intervene as a party by order dated August 20, 1982.

A formal public administrative hearing, conducted in accordance with the Board's Rules of Practice for Hearings (12 C.F.R. Part 263), was held on September 8, 9, 10, 14, 15, and 16, 1982, in Washington, D.C., before an Administrative Law Judge appointed at the request of the Board. A substantial record on the application was developed through the submission of exhibits and testimony and through the participation of the SIA, BAC, the Department of Justice, and other interested parties.

In a Recommended Decision dated November 12, 1982, Administrative Law Judge Ernest G. Barnes concluded, based upon the evidence of record, that BAC's application met the criteria of section 4(c)(8) of the Act and, accordingly, recommended that the Board approve the application without condition. The SIA and BAC timely filed exceptions to the Administrative Law Judge's Recommended Decision.

Having carefully considered the entire record of the proceeding, including the comments received, and the transcript, exhibits, written testimony, rulings, and briefs filed in connection with the hearing, the Recommended Decision filed by the Administrative Law Judge, together with the exceptions thereto, the Board has determined that the Administrative Law Judge's findings of fact, conclusions, and recommendations, as modified and supplemented herein, are fully supported by the evidence of record and should be adopted as the findings and conclusions of the Board.

BAC, with total consolidated assets of $120.5 billion is one of the two largest banking organizations in the United States.[1] BAC operates one subsidiary bank, Bank of America N.T. & S.A., San Francisco, California ("Bank"). Bank, with domestic deposits of $51.9 billion,[2] is the largest commercial bank in the United States. BAC also operates numerous nonbanking subsidiaries located throughout the United States and abroad, including subsidiaries engaged in consumer and commercial lending, mortgage banking, leasing, data processing, investment advisory services, and certain credit-related insurance underwriting and insurance agency activities in California.

Schwab is a retail discount securities brokerage firm headquartered in San Francisco, California. Schwab operates 51 offices in 26 states and the District of Columbia, and has recently opened an additional office in Hong Kong. Schwab is a member of, and maintains seats on, various national and regional securities exchanges, including the New York Stock Exchange, the Chicago Board Options Exchange, and the Pacific Stock Exchange, and is registered with the Securities and Exchange Commission pursuant to section 15 of the Securities Exchange Act of 1934. Schwab buys and sells securities solely as agent, on the order and for the account of customers. Schwab does not purchase or sell securities for its own account except to an insignificant extent, does not engage in dealing or underwriting, and gives no investment advice. Schwab characterizes itself as a "discount" broker because its commissions are significantly lower than those charged by full-time brokers. In addition to brokerage services, full-line brokers offer investment advice. A Schwab customer is not assigned a personal representative but deals with any available representative, who in many cases enters the customer's order in an automated execution system, which can execute the order in as short a time as thirty seconds.

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1 Asset data are as of September 30, 1982.

2 Deposit data are as of December 31, 1981.

Schwab also extends credit for the purchase and carrying of securities and provides securities custodial services and various other services related to maintaining customer accounts, such as individual retirement accounts, a "sweep" arrangement with an unaffiliated money market mutual fund, payment of interest on net free balances awaiting investment, and third party payment services.

Schwab's Activities Are Closely Related to Banking

Section 4(c)(8) of the BHC Act permits a bank holding company to engage, directly or through a subsidiary, in activities that the Board, after due notice and opportunity for a hearing, has determined by order or regulation to be "so closely related to banking . . . as to be a proper incident thereto." The statutory standard requires that two separate tests be met for an activity to be permissible for a bank holding company. First, the Board must determine that the activity is, as a general matter, "closely related to banking." Second, the Board must find in a particular case that the performance of the activity by the applicant bank holding company may reasonably be expected to produce public benefits that outweigh possible adverse effects.

Based on guidelines established in *National Courier Association* v. *Board of Governors*,[3] a particular activity may be found to meet the "closely related to banking" test if it is demonstrated that (1) banks generally have in fact provided the proposed activity; (2) banks generally provide services that are operationally or functionally so similar to the proposed activity so as to equip them particularly well to provide the proposed activity; or (3) that banks generally provide services that are so integrally related to the proposed activity as to require their provision in a specialized form. However, the *National Courier* guidelines are not the exclusive basis for finding a close relationship between a proposed activity and banking.[4]

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3 516 F.2d 1229, 1237 (D.C. Cir. 1975).

4 *Id.*

A. *Retail Securities Brokerage*

The undisputed facts of record demonstrate that many banks currently offer certain types of securities brokerage services. Many banks provide informal brokerage services, in which, as an accommodation to their customers, banks transmit customer orders to buy or sell securities selected by their customers to brokers for execution. In addition, banks, through the trading desks of their trust departments, routinely buy and sell securities as agent for trusts and other accounts managed by banks.[5]

As the SIA points out, Schwab's activities differ somewhat from the brokerage functions usually performed by banks: Schwab executes orders for the purchase or sale of securities directly, without the assistance of an intervening broker; and executes directly on the exchange orders involving securities listed on such exchanges. The Board finds, however, that Schwab's brokerage services are operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well equipped to provide such services.[6]

The record shows that, as part of their current services, banks often execute orders involving securities not listed on an exchange by dealing directly with dealers making a market in the particular security or with other third parties. In performing these services, banks exercise the same type of discretion and judgment with respect to the best method of execution that brokers do with respect to similar types of orders. Moreover, many banks use a number of brokers to execute orders placed

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5 Banks also administer employee stock purchase, dividend reinvestment, and automatic investment service plans, which involve the periodic purchase of a particular security or securities from a fixed list of securities, on behalf of a customer.

6 The Board has found that the execution of unsolicited orders to buy or sell securities primarily of Israeli corporations solely as agent of the customer by a company that is not a member of a securities exchange is closely related to banking. *JCT Trust Company, Ltd.*, 67 Federal Reserve Bulletin 635 (1981).

with the bank by its customers or trust department. The record shows that in selecting a particular broker to execute a given order (especially in the case of orders for a block of securities), these banks make the decision themselves as to the best method of execution, leaving to the broker only the technical execution of the transaction. The Securities and Exchange Commission's 1977 report on bank securities activities found that bank trust department trading desks, at least at the largest banks, perform the same functions, utilize the same execution techniques, employ personnel with the same general training and expertise, and use the same facilities, *e.g.*, the consolidated tape, Quotron, AutEx, and other market information services, that brokers do.

In addition, national banks are expressly authorized by statute to purchase and sell securities without recourse, solely upon the order, and for the account of, customers. 12 U.S.C. § 24 Seventh. This authority supports the conclusion that Schwab's brokerage activities, which are within the plain meaning of the language of this authorization, are closely related to banking.[7]

Although the record indicates that in 1977 generally only the largest banks employed sophisticated securities trading procedures and resources, the record also shows that the technological changes in the securities markets and other developments have forced bank securities traders in large banks to develop and expand their skills and that this trend is expected to continue.[8] The Board finds that the use of sophisticated tech-

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7 The SIA asserts that this statutory authorization is limited to providing accommodation brokerage services to existing customers of the bank. Even if this assertion were correct, the fact that an activity is not permitted to a bank does not preclude a finding that the activity is *closely related* to banking and thus permissible for a bank holding company. *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 64 (1981).

8 Schwab also maintains customers' accounts and clears and settles executed transactions. Banks perform these functions in connection with the buy or sell orders banks effect for trust departments and as an accommodation to their customers. In addition, as a retail broker,

niques, resources and personnel to execute orders for the purchase or sale of securities for the account of customers is sufficiently widespread in the banking industry to justify a finding that banks generally provide securities execution services that equip them to offer the type of retail brokerage services provided by Schwab. Moreover, the Board finds that execution "in the crowd" on an exchange[9] is a largely ministerial function that involves no greater expertise or resources than the execution of orders directly with third party market makers, which banks generally now perform.[10]

The conclusion that Schwab's brokerage activities are closely related to banking is also consistent with the purposes of the BHC Act, which mandates the separation of banking from commerce in order to guard against the potential concentration of financial resources, conflicts of interest in the control of credit, and risks to insured depository institutions that are likely to result from the control by banking organizations of commercial enterprises. The laws restricting bank involvement in the investment banking business generally, while expressly recognizing that banks have been historically involved in some

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Schwab deals directly with the public to a far greater extent than the typical bank that offers securities brokerage services. However, the Board concludes that the degree of contact with the public does not substantially alter the type of expertise and judgment necessary to perform execution services, which in the case of both Schwab and banks generally is substantially the same.

9 Exchange members that are specialists in particular securities may exercise significant discretion and judgment with respect to trading in those securities. Specialists, however, trade for their own account. Schwab does not buy or sell securities for its own account and is not, therefore, a specialist on any exchange.

10 The fact that in many cases banks rely on brokers to execute customer orders placed with the bank does not preclude a finding that banks are well equipped to execute these orders directly, since the record shows that to a significant extent banks do effect buy and sell orders directly without the intervention of a broker or employ the broker merely to carry out the decision as to the method of execution made by the bank.

types of securities activities, are also designed to avoid conflicts of interest and risks to the safety of depository institutions.

B. *Margin Lending*

Schwab also engages in the extension of margin credit to Schwab's brokerage customers for the purchase and carrying of securities. Banks generally and traditionally have extended credit to their customers for the purpose of buying and carrying securities. At the end of 1981, banks had outstanding approximately $5 billion in loans to borrowers other than securities firms or financial institutions for the purpose of purchasing or carrying securities. In addition, the extension of credit secured by stock and other collateral has long been an important bank activity. The Board's margin credit regulations apply both to brokers such as Schwab (Regulation T) and to banks (Regulation U).[11] While Regulations T and U impose somewhat different requirements, the underlying margin credit activity engaged in by both banks and brokers is functionally the same. The Board therefore concludes that Schwab's margin lending activity is closely related to banking.

C. *Maintenance of Customer Securities Accounts*

In connection with carrying accounts of its securities brokerage customers, Schwab offers various services to its brokerage customers. These services include: (1) Individual Retirement Accounts, for which an unaffiliated savings and loan association serves as trustee; (2) a "sweep" arrangement, pursuant to which idle customer balances exceeding a predetermined minimum are automatically invested in an unaffiliated money market mutual fund; (3) the payment of interest on net free balances awaiting investment; and (4) the "Schwab-One Account," which combines the payment of interest on free credit balances with customer access to such balances through a debit card and checking account offered under an arrangement with

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11 12 C.F.R. Parts 220, 221.

an unaffiliated commercial bank. These services are increasingly being offered by other brokerage firms. The Board finds that each of these services is identical, or functionally and operationally equivalent to, services generally offered by banks to customers directly or through banks' trust departments. Accordingly, the Board finds, on the facts of this case, that BAC's provision through Schwab of IRA accounts, a money market sweep, and the "Schwab One Account" is closely related to banking as well as an incidental activity in connection with Schwab's securities brokerage and margin lending activities.

D. *Custodial Services*

Schwab also provides various types of securities custodial services, involving the safekeeping of customers' securities, accounting for dividends or interest received on such securities, and other ancillary services. Banks generally offer securities custodial services in connection with their trust department and other securities transaction services. In addition, in extending margin credit, a lender is required to maintain custody of the securities pledged to the lender as collateral to secure the loan. Accordingly, the Board finds that the provision of securities custodial services is closely related to banking and is a necessary incident to permissible margin lending activities.

"Proper Incident"—Net Public Benefits

With respect to the "proper incident" requirement, section 4(c)(8) of the Act requires the Board to consider whether the performance of the proposed nonbanking activity by an affiliate of a bank holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." The Board finds that consummation of this proposal can reasonably be expected to result in public benefits outweighing possible adverse effects.

A. *Public Benefits Are Likely to Result from the Proposal*

1. *Increased Competition*

The record shows that the proposed acquisition is likely to make Schwab a more effective competitor in the retail brokerage market. It is likely that the proposal will strengthen Schwab as a competitor by affording Schwab greater acceptability by the public. The record indicates that discount brokers in general are hampered competitively, at least to some extent, because of a lack of public awareness and acceptance of their services due, in large part, to the relatively recent emergence of discount brokers and their lack of extensive office networks. Schwab's affiliation with BAC, a large, internationally recognized and diversified banking and financial services company with substantial resources, can reasonably be expected to result in enhanced public recognition and confidence in Schwab in particular, and discount brokers in general.

As a relatively new and small company, Schwab needs capital in order to expand its office network and facilities. It is undisputed that, because of its affiliation with BAC, Schwab expects to be able to obtain funds at a lower cost and more efficiently than at present.[12] The proposal is also likely to provide Schwab with access to BAC's managerial and technological resources, which, in view of BAC's size and expertise, are likely to assist Schwab in becoming a more effective competitor.[13]

Strengthening Schwab as a competitor is likely to have a procompetitive impact on price competition in the retail bro-

12 The SIA's claim that Schwab currently has no difficulty in raising capital is immaterial (even if true), since an improvement in the cost and methods of raising funds is likely to produce an increase in Schwab's ability to compete for brokerage services. As explained below, the anticipated improvement in funding would not result in any unfair competitive advantage, because, among other things, BAC, not Bank, would provide funds to Schwab.

13 BAC has an extensive network of offices in this country and in many other countries and plans to assist Schwab in opening new offices.

kerage industry.[14] Since Schwab, like other discount brokers, competes primarily and aggressively on the basis of price, the strengthening of Schwab may induce full-line brokers to compete more vigorously for brokerage business on the basis of price. It is uncontested that the lower commission rates charged by discount brokers are taken into account by full-line brokers. The Recommended Decision forecast that this acquisition might produce a major change in the price structure of the brokerage industry by causing full-line brokers to "unbundle" their services. However, the evidence in the record is not substantial either in support of or against such a change. In any event, the acquisition is likely to have some procompetitive effect.

With respect to the likelihood of increased competition in the development of technology and in the provision of new combinations of financial services, the record indicates that Schwab has developed one of the most sophisticated automated order execution systems in the industry, which is important to Schwab's competitive efforts. Since this type of automated technology is rapidly developing and requires large financial resources to support such development, Schwab's access to BAC's funding support and technical resources can aid Schwab in continuing to offer efficient automated systems, which is likely to have a procompetitive effect throughout the industry.

2. *Increased Convenience and Efficiencies*

With respect to projected increases in convenience and efficiencies, the record shows that BAC will assist Schwab in adding new offices, some of which may be at locations where Bank has branches or where BAC's other nonbank subsidiaries have offices. While most of Schwab's brokerage business is done by telephone or mail, there is evidence in the record that some office locations are necessary to provide effective service.

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14 The SIA claims that there already is active price competition among retail brokerage firms. However, the fact that a market already is competitive does not preclude any further increase in competition.

Customers can make payments and deposit securities at Schwab offices without the inconvenience or cost of, or risk of nondelivery by, mail.

Moreover, the acquisition will permit Schwab and BAC to share their capital, managerial, technological, and marketing resources. In addition, by facilitating joint purchases or securities brokerage and other financial services, the acquisition can be expected to result in lower consumer search costs and greater efficiency in the purchase of such services.

In summary, the Board finds that this acquisition can reasonably be expected to result in some significant public benefits in the form of intensified competition, increased efficiency, and greater consumer convenience in the provision of retail securities brokerage services to the public.

B. *Lack of Significant Adverse Effects*

Having considered the facts of record and the allegations of all of the parties, the Board finds that the proposal is not likely to result in any significant adverse effects.

1. *Unlikelihood of Undue Concentration of Resources or Decreased Competition*

Assessment of the potential competitive impact of this proposal begins with a definition of the relevant product and geographic markets. The relevant product market includes all products that are reasonably interchangeable in practical function and use.[15] It is not disputed that retail securities brokerage constitutes a relevant product market. The SIA contends that discount securities brokerage is a relevant product submarket.[16] Based on the facts of record, the Board concludes

15 E.g., *United States* v. *E.I. duPont de Nemours & Co.*, 351 U.S. 377, 395 (1956).

16 The existence of a product submarket is determined by examining such practical indicia as industry or public recognition as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors. *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325 (1962).

that discount brokerage is not a sufficiently unique product to be considered a separate submarket. The record shows that some discount brokers offer investment advice in addition to the execution of buy and sell orders, while some full-line brokers offer discount brokerage services to large, active retail customers. According to the record, discount and full-line brokers are viewed by the public as reasonable substitutes, since many of Schwab's new customers are gained from full-line brokers, while Schwab has lost customers to full-line brokers.

The relevant geographic market is comprised of the market area in which the seller operates and to which the purchaser can practicably turn for supplies.[17] With 51 offices in 26 states and the District of Columbia, Schwab operates nationwide. Schwab is licensed to do business in all fifty states, has a uniform nationwide pricing policy, and advertises chiefly in nationwide financial publications. Customers can obtain access to Schwab's service from any place in the country by calling a toll-free telephone number. Based on this and the other evidence of record, the Board finds that the relevant geographic market for purposes of this proposal is the United States.[18]

The Board finds that this acquisition will not result in any significant reduction of competition or any increase in concentration of resources to an undue level in any relevant market. With respect to undue concentration of resources, while BAC has substantial assets ($112.9 billion in 1981), Schwab is not of significant asset size ($104 million). BAC's acquisition of

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17 *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 359 (1963).

18 The SIA claims that the State of California is the relevant geographic market on the theory that that area represents the area of competitive overlap between BAC and Schwab. This contention ignores the fact that Schwab and BAC each compete in different product markets. For similar reasons, the SIA's contentions regarding the inclusion of nonbank financial institutions in the banking product market are immaterial, since Schwab, the firm to be acquired, does not engage in banking activities.

Schwab (an increase of less than one per cent in BAC's assets) would not result in any unwarranted increase in the concentration of resources controlled by BAC.

The record indicates that Schwab's acquisition by BAC would not eliminate any significant existing competition in the nationwide retail brokerage market.[19] Schwab's share of the retail brokerage market, expressed in terms of a percentage of total commissions in that market, is less than one per cent. Bank's brokerage activities, primarily an accommodation for existing customers and employees, do not represent a significant market share.[20] While BAC may be viewed as a potential entrant into the retail securities brokerage market, that market is unconcentrated and characterized by low barriers to entry and numerous potential entrants.

The SIA notes that BAC anticipates an increase in Bank's deposits after the acquisition as a result of cross-selling Bank's services to Schwab's customers. While significant concentration exists in some local California banking markets and BAC's market share in those markets is significant, this acquisition will not directly cause any increase in Bank's deposits in any market. Such an increase, if it occurs, would result from success in cross-selling by BAC. In any event, the projected increase in Bank's deposits is of *de minimis* proportions.[21]

19 Both Bank and Schwab engage in extending margin credit for the purchasing and carrying of securities. To the extent margin lending is a separate product, the proposal would not eliminate any significant competition. Neither Bank's nor Schwab's outstanding margin loans are substantial.

20 There is no substantial record evidence that the Board's conclusion concerning lack of elimination of potential competition would be altered even if discount brokerage were viewed as a product submarket. The record does not indicate that such a submarket is highly concentrated or that the number of potential entrants is low. Indeed, recent developments suggest that many banks must now be viewed as likely entrants into any such discount brokerage submarket.

21 It is not likely that BAC would gain significant competitive advantage from the projected growth in Bank's deposits since other large California banks, *i.e.*, Security Pacific National Bank and Crocker

The SIA contends that BAC's acquisition will eliminate competition in the brokerage product market by forcing other discount brokers either to become affiliated with a banking organization or be driven from the market. There is no evidentiary support for this allegation. However, even if the SIA's hypothesis is correct, it does not necessarily lead to the conclusion that competition will be diminished as a result. Indeed, such affiliations are likely to increase the vigor of competition. Moreover, the SIA does not contend that the acquisition will preclude any further entry into the retail brokerage market.

2. *Unlikelihood of Unfair Competitive Practices*

The SIA contends that, as a result of the acquisition, Schwab would have an unfair advantage over other brokers in the rates Schwab would pay for its funding. BAC plans to provide funding to Schwab by lending to Schwab the proceeds of funds raised directly by BAC. The SIA asserts that, because of explicit and implicit guarantees given by the federal government to the creditors of Bank (BAC's major asset),[22] BAC is able to raise funds at lower rates than brokerage firms that are not affiliated with a bank. According to the SIA, this alleged funding advantage is unfair because it rests on federal guarantees unavailable to brokerage firms not affiliated with banking organizations.[23] The SIA also argues that after the acquisition Schwab could obtain funds from BAC at rates lower than it currently pays and that this reduction in funding costs is not economically justified. The Board finds no significant adverse

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National Bank, have recently entered the retail brokerage field, and other banking organizations are also likely to enter.

22 Creditors of a bank holding company are not protected by federal deposit insurance. The SIA contends, however, that the government would come to the aid of any large bank in difficulty to maintain the stability of the financial system and that such assistance would benefit the parent holding company.

23 Brokerage firms benefit from a federal guaranty, *i.e.*, the Securities Investor Protection Corporation.

effects are likely to result from the proposed method of funding Schwab.

The record does not demonstrate that BAC's costs of funds are significantly lower than those of other corporations of similar resources. For example, the rates paid by BAC on its commercial paper during May through July 1982 were generally the same or higher than rates on commercial paper paid by corporations of similar size and credit ratings. Moreover, any cost advantage in raising funds enjoyed by BAC may be due to economic factors such as BAC's size, capital, and earnings, rather than to any guarantees applying to Bank alleged by SIA.[24] In any event, the Board finds that any advantage Schwab might obtain as the result of its borrowing from BAC is not unfair competition for purposes of section 4(c)(8). The legislative history of that section indicates that the term "unfair competition" was intended to refer to unfair or unethical business conduct (as defined by common law or under state or federal law), not disparities or advantages based on the structure and operations of the banking industry.[25] While the original 1956 BHC Act severely restricted borrowing by a bank holding company (or its nonbank subsidiaries) from its subsidiary bank,[26] Congress expressly declined to prohibit "downstream" financing, *i.e.*, borrowing by any subsidiary in the system from the parent. Congress found that downstream

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24 BAC states that funds for Schwab would be provided by the parent holding company, not by Bank. Thus, any cost advantage Bank might enjoy because its deposit liabilities are federally insured is immaterial. In any event, it should be emphasized that the extent to which funds from Bank may be transferred to Schwab is strictly limited by section 23A of the Federal Reserve Act. 12 U.S.C. § 371c.

25 H.R. Rep. No. 1747, 91st Cong., 2d Sess. 18-19 (1970). The legislative history identified such practices as intimidation of customers and commercial espionage. *Id.*

26 70 Stat. 133, 137. These limitations were repealed in 1966 on the grounds that they were unnecessary in light of the similar, more flexible restrictions in section 23A of the Federal Reserve Act. 80 Stat. 236, 240; S. Rep. No. 1179, 89th Cong., 2d Sess. 10-11 (1966).

financing is a beneficial advantage of the bank holding company structure and permits the parent holding company to draw on its own capital and funds to strengthen the financial condition of its subsidiaries.[27] Recognizing this advantage, Congress authorized bank holding companies to acquire certain types of *nonbank* subsidiaries, which would compete against firms in the same line of commerce.

Moreover, the Board finds no basis in the SIA's claim that Schwab's ability to obtain low cost funding from BAC is economically unjustified. The Administrative Law Judge found, and the SIA does not contest, that the rate of interest BAC charges its subsidiaries on loans to such subsidiaries reasonably approximates BAC's own cost of funds. Moreover, the fact that the rates at which Schwab would be able to obtain funding might be lower than the rates at which other brokers pay does not *per se* demonstrate that the rates BAC charges Schwab are unfair or unjustified, since other economic factors not applicable to Schwab or BAC (*e.g.*, lower capital or earnings or lack of complete credit information) might justify higher rates paid by other brokers.[28]

The SIA also asserts that BAC intends to cross-sell banking services to Schwab customers, and thus has an incentive to subsidize Schwab's brokerage business. Cross-subsidization is an unfair competitive practice that occurs when the profits of one company are used to enable an affiliated company to offer its services at prices below its costs.[29] Cross-subsidization is successful, and therefore a likely practice, only where a company offering below-cost pricing has sufficient market domi-

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27 S. Rep. No. 1095, 84th Cong., 1st Sess. 15 (1955).

28 The Board does not accept the SIA's contention that BAC will lend funds to Schwab without regard to the risk involved. The record indicates that BAC does account for risk in determining the amount of funds to advance to a nonbank subsidiary and in determining whether an appropriate return will be earned on such advances.

29 *E.g.*, *Citicorp (Citishare)*, 68 Federal Reserve Bulletin 505, 512 (1982).

nance to be able to eliminate competitors by sustained below-cost pricing and thereafter to raise prices to recover the losses incurred through offering services below cost. It is clear from the record that Schwab does not have such a dominant position in the retail brokerage market and that the industry has very low barriers to entry. There is no evidence that BAC plans to offer brokerage services through Schwab at below Schwab's costs. The evidence shows that BAC expects Schwab to provide a positive return on equity.[30] The record evidence showing that BAC intends to cross-sell banking services to Schwab brokerage customers does not in itself demonstrate that BAC will cause Schwab to offer services at below cost.

Bank serves as a dealer in municipal securities. After the announcement of this proposal, BAC and Schwab entered into an arrangement under which Schwab provides its customers with information on municipal securities Bank holds in its inventory. The SIA contends that, since bank dealers in municipal securities enjoy more favorable tax treatment than nonbank dealers,[31] the arrangement between Schwab and Bank would permit Bank to exploit this allegedly "unfair" competitive advantage. However, the Board finds that any such competitive advantage results from the application of the federal tax laws, which affect all participants in the municipal securi-

30 The SIA contends that BAC will have an incentive to subsidize Schwab's services because SIA expects that some Schwab customers will bring business to Bank and that Bank's earnings from this increased business will be greater than the losses caused by offering brokerage services at below cost. This contention, in the Board's view, is not based on any evidence in the record. The Board also notes that competition by financial institutions for deposits is strong, making it unlikely that Bank would be able to attain profit levels on deposits by customers of Schwab that would justify cross-subsidization. Moreover, in this connection, the Board notes that federal limitations on interest rates payable on deposits are being rapidly eliminated, resulting in increases in the cost of deposits.

31 The interest paid by nonbank dealers on funds borrowed to finance their inventory of municipal securities is not deductible for federal income tax purposes. 26 U.S.C. § 265(2). Bank dealers are exempt from this provision.

ties markets, and does not represent the type of adverse effect about which the BHC Act was concerned.

The Board further finds that the risk of voluntary tying of bank credit to use of Schwab's brokerage services is not substantial, given existing legal,[32] regulatory and internal BAC safeguards, and the record facts. Voluntary tying results when a customer believes that he or she stands a better chance of obtaining a scarce product by purchasing another product or service from the same seller. Where both products are in ample supply, voluntary tie-ins are not likely. These implicitly coerced joint sales are different from voluntary joint sales which, as the Administrative Law Judge found, can result in benefits to the customer by reducing search costs for the consumer and increasing efficiencies inherent in joint production and sale.

As the Board has previously found, the likelihood of voluntary tying depends on market structure and on the offering of a product that is relatively scarce.[33] The possibility of such tying is significantly reduced in competitive markets where there is a large number of alternative sources of the product involved (*e.g.*, credit). The Board finds that there are many alternative sources of credit (both bank and nonbank) available to the customers (mostly individuals) that are likely to use a discount broker like Schwab.

The SIA claims that because BAC intends to promote Schwab's services and because Bank's pricing of loans or other services, as a matter of policy, takes account of a customer's relationship with a nonbank subsidiary in the BAC system, there is the likelihood of implicitly coerced joint sales. The record shows that employees of Bank are expressly advised not

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32 Explicitly coerced joint sales are expressly prohibited by section 106 of the BHC Act Amendments of 1970, 12 U.S.C. §§ 1972-78, and are not an issue in this application.

33 *E.g.*, *Citicorp (Person-to-Person Financial Center)*, 67 Federal Reserve Bulletin 443, 446 (1981). There is no evidence that brokerage services are such a scarce service that brokerage customers of Schwab will feel implicitly coerced into seeking deposit or credit services of Bank in order to continue to obtain brokerage services from Schwab.

to create even the impression that a customer might enhance the likelihood of obtaining a desired service by purchasing other products or services from Bank or its affiliates. Moreover, the record shows that customers of Bank that would be likely to use a discount broker are also likely to be (as are Schwab's current customers) relatively knowledgeable about financial matters. Such customers are less likely to be implicitly coerced into using brokerage services that are not independently desired. The Board does not believe the evidence suggests the likelihood of significant coerced joint sales.

3. *Unlikelihood of Other Adverse Effects*

The Board finds no persuasive evidence that BAC's acquisition of Schwab would result in significant conflicts of interest. The possibility that Bank might make unsound loans to Schwab customers to maximize Schwab's profits is not substantial and is neither based on evidence nor reasonable. Moreover, it would not be rational for Bank to place its own funds at risk in an unsound loan merely to increase brokerage commissions earned by Schwab. The Board finds no realistic basis for the SIA's contention that Schwab might "dump" worthless municipal securities on its customers as a result of its arrangement with Bank's municipal securities dealer operations. Under this arrangement Schwab identifies for its customers municipal securities held in Bank's inventory and does not give investment advice concerning the purchase or sale of the securities. There does not appear to be any substantive basis for any conflicts of interest arising from this procedure. Nor is there any credible evidence that Bank would breach its fiduciary duty by placing orders with Schwab for the purchase or sale of securities by Bank's trust department or customers where Schwab would not effect the best execution of the order.[34] There is no record evidence suggesting that Bank

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34 Bank's trust department is subject to a judicially enforceable duty to obtain best execution of orders under applicable statutes (15 U.S.C. § 78bb(e)(2)) and related regulations of its federal supervisor. 12 C.F.R. § 9.5, 47 Fed. Reg. 27831 (1982).

would use Schwab's services in situations that would result in a breach of fiduciary duty.

The earnings of discount brokers are heavily dependent on the volume of trading in securities and have fluctuated to a significant degree. However, the SIA's claim that Schwab is a high risk enterprise and that BAC might be compelled to make unsound loans to shore up Schwab is not supported by the record. Despite fluctuations in earnings, discount brokers in general, and Schwab in particular, have been profitable. Schwab's income has grown significantly in recent years. Schwab is not a speculative enterprise and the financial risks to BAC as a result of this proposal do not appear to be any greater than the risks involved in other permissible nonbank activities. The Board finds that it is unlikely that significant financial risks to BAC or Bank would result from the proposal.

The Board finds no basis for the SIA's contention that, because BAC intends to advertise its affiliation with Schwab, the proposed acquisition would result in public confusion. There is no evidence that BAC would misrepresent the nature of Schwab's affiliation with BAC or Bank, and BAC should assure that fully adequate disclosure of the status of Schwab obligations is made available to all customers.

The SIA further contends, without any evidentiary record for its claim, that Schwab solicits customers to place funds in Schwab's cash management account solely to earn interest and not for purchasing securities, that such funds might not be protected by Securities Investor Protection Corporation insurance (a protection that Schwab advertises), and that such an account constitutes the unlawful taking of deposits. The Board finds no basis for this allegation on the facts of this case. Guidelines issued by the Securities and Exchange Commission restrict registered brokers, such as Schwab, from soliciting funds solely to earn interest.[35] The rules of the New York Stock Exchange prohibit a member (such as Schwab) from paying interest on any free credit balance created for the purpose of

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35 3 Fed. Sec. L. Rep. (CCH) ¶ 25,134B.

receiving interest.[36] There is no evidence that Schwab will not comply with these limitations or that Schwab's advertising of SIPC insurance will be materially misleading.

In the exercise of its responsibility under the BHC Act, the Board has carefully considered whether BAC's financial and managerial resources are adequate to effect the proposed acquisition. In its evaluation of BAC's financial resources, the Board has reviewed all the relevant data concerning BAC's financial condition. Based upon this review, the Board concludes that the proposed acquisition would not represent a significant additional burden on BAC's financial resources. The Board notes the improvement in BAC's capital over the past year and expects that BAC will continue its efforts to improve its capital position. On balance, the Board concludes that BAC has both financial and managerial resources that are consistent with approval.

In sum, the Board finds that this acquisition may reasonably be expected to result in public benefits that outweigh possible adverse effects. Accordingly, since this acquisition satisfies both the "closely related" and the net public benefits tests of section 4(c)(8), the Board finds no basis for the SIA's contention that BAC must be required to enter the retail securities brokerage industry *de novo*.[37]

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36 *Id.*

37 The decisions cited by the SIA where the Board has denied the acquisition of a going concern by a bank holding company with the resources for *de novo* entry are inapposite. In those cases, the Board expressly found that acquisition of the going concern would eliminate substantial potential competition. *BTNB Corp.*, 58 Federal Reserve Bulletin 70, 71 (1972); *Marine Bancorporation*, 58 Federal Reserve Bulletin 504, 505 (1972); *Crocker National Corp.*, 58 Federal Reserve Bulletin 419, 420 (1972). Section 4(c)(8) does not require *de novo* entry by a bank holding company if, as here, the company's acquisition of a going concern will not substantially lessen competition and is likely to produce benefits that outweigh possible adverse effects.

The Acquisition Is Consistent with the Glass-Steagall Act

The SIA and various other commenters contend that the acquisition of a securities brokerage firm by a bank holding company is prohibited by provisions of the Glass-Steagall Act, the popular term for provisions of the Banking Act of 1933, that insulate commercial banking from certain aspects of the securities business. Section 20 of the Glass-Steagall Act (12 U.S.C. § 377) prohibits the affiliation of any bank that is a member of the Federal Reserve System with any corporation or similar organization that is "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities.[38] For the reasons stated and upon the findings made in this Order, the Board concludes that Schwab is not engaged principally in any of the activities prohibited to member bank affiliates by the Glass-Steagall Act and accordingly concludes that this acquisition is consistent with the letter and spirit of that Act.

As a result of the consummation of this proposal, Bank, a member bank, would become affiliated with Schwab for purposes of section 20.[39] The SIA alleges that Schwab is engaged principally in the "public sale" of securities within the proscription of section 20 by virtue of its retail brokerage activities.[40] The Board finds, however, that the business of purchasing or selling securities upon the unsolicited order of, and as agent for, a particular customer does not constitute the

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38 Section 16 of the Glass-Steagall Act, 12 U.S.C. § 24 Seventh, provides that a national bank's dealing in securities and stock is limited to "purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers" and not for the bank's own account, and that a national bank "shall not underwrite any issue of securities or stock." Section 21, U.S.C. § 378, prohibits any organization that receives deposits to engage at the same time "in the business of issuing, underwriting, selling, or distributing" securities.

39 12 U.S.C. § 221a(b)(2).

40 It is undisputed that Schwab's brokerage activities do not constitute the "issue, flotation, underwriting . . . or distribution" of securities.

"public sale" of securities for purposes of section 20. It is significant that, in describing proscribed activities of bank affiliates, section 20 does not mention "brokerage" activities, the generic term commonly associated with the business of buying and selling securities as agent for a customer.[41] In addition, in executing a customer's order to buy or sell securities, a broker does not make a public offer or hold itself out to the public as a seller or buyer for its own account but only acts as agent to assist the seller or buyer.[42] Furthermore, the terms "issue," "flotation," "underwriting," and "distribution" (used in section 20 in conjunction with "public sale") generally refer to the process by which new issues or large blocks or securities are distributed to the public, not to brokerage functions, which are primarily concerned with the transfer of securities at the request of a particular customer.[43] The term "public sale" used in association with this series of terms should be given a meaning similar to those terms since, under the rules of statutory construction, words grouped in a list should be given a related meaning.[44]

The view that "public sale" was not intended to apply to purchasing or selling securities as agent for a customer is further supported by the fact that the Board has consistently interpreted section 32 of the Glass-Steagall Act (12 U.S.C. § 78) as not applying to any brokerage activities. Section 32

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41 2 L. Loss, *Securities Regulation* 1215 (2d ed. 1961). A securities *dealer* sells securities it has purchased for its own account elsewhere or purchases securities for its own account with a view toward selling them elsewhere. *Id.* A dealer ordinarily maintains an inventory of particular issues of securities and holds itself out to the public as being willing to purchase or sell such securities for its own account. A dealer is thus unlike a broker, which acts for the account of a customer.

42 *Cf.* Securities and Exchange Commission, Final Report on Bank Securities Activities 121-22, 167 (1977).

43 1 L. Loss, *supra* at 159-72.

44 *E.g.*, *Third National Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977).

prohibits managerial interlocks between a member bank and a firm primarily engaged in the same securities activities described in section 20. Beginning in 1936, the Board's Regulation R, which implements the provisions of section 32, has consistently provided that "[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32."[45] Since section 20 and section 32 are part of the same statute and were enacted for the same purpose, the meaning of "public sale" as used in section 20 should be interpreted consistently with the same term in section 32.[46]

The SIA and other commenters contend that Schwab's retail brokerage activities are prohibited to banks under section 16 of the Glass-Steagall Act and thus should not be permitted to affiliates of banks. However, as the Supreme Court has made clear, section 20 determines the permissible securities activities of an affiliate of a bank and the fact that a bank might be precluded from engaging in a particular securities activity does not necessarily mean that a bank holding company is precluded from performing such service.[47] Moreover, section 16 *authorizes* national banks to engage in retail brokerage, *i.e.*, to

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45 22 Federal Reserve Bulletin 51 (1936), *codified at* 12 C.F.R. § 218.1 n.1.

46 The Board's view that brokerage activities do not constitute the public sale of securities was implicitly upheld by the Supreme Court in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947). In *Agnew*, the Court affirmed a Board order finding that a particular securities firm with significant income from both underwriting activities and brokerage activities was "primarily" engaged in underwriting securities and thus covered by section 32. 329 U.S. at 445-46. The Supreme Court affirmed the Board's finding that the firm was primarily engaged in underwriting even though the amount of underwriting done by the firm did not exceed 50 per cent of its business. *Id.* at 447-49. The Court left undisturbed the Board's implicit finding that the brokerage business was not part of the business described in section 32.

47 *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 63-64 (1981).

engage in "purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers." 12 U.S.C. § 24 Seventh.

The SIA concedes that section 16 expressly authorizes some securities brokerage activities for banks, but contends, based on early interpretations of section 16 by the Comptroller of the Currency, that national banks are limited to executing orders without profit and only as an accommodation to existing customers, and that Schwab's services, not tied to the customers of any bank, clearly exceed these limitations.[48] However, beginning in 1957, the Comptroller has gradually departed from these early interpretations on the grounds that they are not supported by the express language of the statute, reflected an overcautious approach to bank regulation in the aftermath of the Great Depression, and are erroneous. Indeed, the Comptroller has recently authorized a national bank to establish a subsidiary to engage in discount brokerage services substantially the same as those provided by Schwab[49] and has advised the Board, in comments on BAC's proposal, that a national bank's purchase and sale of securities as agent is permissible under the Glass-Steagall Act.[50] In any event, inde-

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48 *See, e.g.*, 20 Federal Reserve Bulletin 609 (1934).

49 Comptroller of the Currency, Decision on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc. (August 26, 1982). The SIA is seeking judicial review of this decision. Among other things, the SIA has alleged that the establishment by a national bank of brokerage offices at locations where the bank is not permitted to branch violates the National Bank Act. The Board finds that there would be no violation of the federal branching laws in this application under the BHC Act, since Schwab is a separate corporation, has its own capital and officers and directors, and would not be operated in a unitary fashion with Bank, but as a nonbank subsidiary of a bank holding company. *See Grandview Bank & Trust Co.* v. *Board of Governors*, 550 F.2d 415 (8th Cir.), *cert. denied*, 434 U.S. 821 (1977).

50 The SIA argues that Schwab's activities do not meet the "without recourse" requirements of section 16, since in many cases Schwab executes transactions directly without the assistance of an intervening

pendent of the validity of the Comptroller's constructions of section 16, the Board finds that Schwab's brokerage functions do not constitute the "public sale" of securities (or any other proscribed activity) within the meaning of section 20 of the Glass-Steagall Act, the applicable statutory provision.[51]

This conclusion is consistent with the purposes of the Glass-Steagall Act. During congressional consideration of the Glass-Steagall legislation, the scope of permissible bank brokerage activity was not discussed in detail.[52] However, since the types of bank securities activities considered harmful and contrary to public policy were exhaustively catalogued in the legislative history and brokerage activities received no serious attention, it is unlikely that Congress viewed such activities as the target of the Act's prohibitions.[53] Indeed, the particular type of securi-

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broker against whom Schwab's customers might otherwise have recourse for any alleged fraud or negligence. However, in the Board's view, the ordinary commercial meaning of "without recourse" indicates that section 16 prohibits a bank from assuming the liability of endorser or maker with respect to the securities bought or sold as agent of the customer. *See* G. Munn & F. Garcia, Encyclopedia of Banking & Finance 943 (7th ed. 1973; U.C.C. § 3-414(1)). There is no evidence that Schwab would assume any such liability.

51 The SIA further asserts that "public sale" in section 20 must be interpreted similarly to the terms "purchasing and selling" as used in sections 16 and 21, which, the SIA contends, clearly include brokerage functions. However, section 16 expressly permits purchasing and selling securities for the account of customers.

52 The relevant legislative history merely states that national banks would be permitted to buy and sell securities for their customers to the same extent as heretobefore. S. Rep. No. 77, 73rd Cong., 1st Sess. 16 (1933).

53 The SIA's reliance on various statements by a draftsman of the Securities Exchange Act of 1934 is without merit. These statements were made after enactment of the Glass-Steagall legislation, are not the views of a member of the legislature, and do not purport to deal with the outer limits of permissible bank brokerage activities. In addition, the Comptroller of the Currency's explanation of the 1935 amendment to section 16 (which merely clarified that the scope of permissible

ties activities engaged in by Schwab are fully consistent with the objectives of the Glass-Steagall Act. As has been widely recognized, the Glass-Steagall legislation was intended to eliminate the risk of loss or insolvency that may result when a bank purchases securities for resale to the public, makes unsound loans to bolster its marketing of particular securities, or loses public confidence when it becomes apparent that the bank has a "salesman's stake" in the success of a particular investment opportunity.[54] Further, as noted above, the Board believes that Schwab's activities pose no greater risk of failure than other nonbanking activities permitted by the Board to bank holding companies. The Board finds that these types of hazards are not present in connection with Schwab's activities, since, except on very infrequent occasions, Schwab does not purchase or sell securities as a principal, *i.e.*, with its own assets.[55] Nor does Schwab have any interest in the success or failure of any particular issue of securities, since its operations are limited to

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brokerage included execution of orders for stock as well as for debt securities) appears merely to be a statement of the Comptroller's now-rejected administrative interpretation of the 1933 legislation.

54 *E.g.*, *Board of Governors* v. *Investment Company Institute*, *supra*, 450 U.S. at 61-62; *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629-34, 635-38 (1971). The SIA's reliance on the Supreme Court's passing remark in the second *ICI* decision that the ACT was intended to divorce banks from underwriters and brokerage houses, 450 U.S. at 63, is misplaced. Brokerage activities were clearly not at issue in that case. Also, most brokerage firms also engage in dealing in securities, an activity that *is* generally impermissible under the Act. *See* 2 L. Loss, *supra* at 1215.

55 Schwab acts as a principal if it mistakenly purchases securities not authorized by the customer. Such "inadvertent principal" transactions are less than one per cent of Schwab's business and clearly not a principal activity. In addition, in infrequent cases, Schwab may purchase municipal securities in a new issue as riskless principal—with its own assets but only after a firm customer order for such securities has been received. These riskless principal transactions (also not a principal activity of Schwab) appear to be consistent with permissible brokerage activities, and, in any event, section 16 expressly authorizes banks to act as principal with respect to certain types of municipal securities.

providing a service enabling investors to purchase or sell expeditiously securities selected by the customer. Although, as the SIA points out, unsuccessful operations by an affiliate may well damage the reputation of a bank or bank holding company, the Board finds that the likelihood of harm to the reputation of BAC or Bank as a result of this proposal is minimal, since Schwab does not actively promote any particular securities and does not offer investment advice.

Schwab also offers to its customers a "sweep" arrangement, under which idle customer balances awaiting investment and exceeding a predetermined amount are routinely and automatically used to purchase shares of an unaffiliated money market mutual fund. The Board has pending before it a separate petition submitted by the SIA alleging that such "sweep" arrangements by banks constitute the impermissible underwriting of the securities of the money market mutual fund and believes that this issue is more appropriately resolved in that context. Even if it is assumed that Schwab's sweep arrangement constitutes underwriting of the money fund's securities, the record clearly shows that Schwab is not principally engaged in that activity. Thus, no violation of section 20 would arise as the result of the present application.

Proposed Restrictions on Schwab's Activities

The SIA asserts that, if the Board determines to approve the proposal, various restrictions should be imposed to address the alleged adverse effects of the acquisition by limiting Schwab's activities solely to securities brokerage, by restricting the method by which Schwab obtains funds, establishes offices, advertises its affiliation with BAC, and by prohibiting Bank from using Schwab to execute transactions for Bank's fiduciary accounts or to sell municipal securities. For the reasons explained above, the Board concludes that significant adverse effects are not likely to result from the proposal and, accordingly, the Board finds that the imposition of the restrictions advanced by the SIA is not warranted. Because BAC's plans to finance and promote Schwab and to place Schwab offices at

some BAC locations are not likely to produce any unfair competitive advantage, public confusion, or other adverse effects, the Board finds no basis to restrict such activities. Also, Bank's use of Schwab to buy or sell securities as agent for the Bank's trust department or to transmit information on Bank's municipal securities inventory should not be prohibited, since these operations present the prospect of no serious adverse effects.[56]

In approving BAC's application to acquire Schwab, the Board grants approval under the BHC Act only for those activities considered by the Board.[57] Thus, any change or expansion in the activities described in this Order would require the approval of the Board.

Consistency with Objectives of the BHC Act

The Board has reviewed this application from the viewpoint of its basic consistency with the objectives of the BHC Act. This Act was designed to eliminate the potential for conflicts of interest and concentration of resources that are inherent in the commingling of banking and commerce to help maintain banks as impartial providers of credit, to avoid the anticompetitive effects that would inevitably arise from close links between the control and use of credit, and to protect the banking system and ultimately the economy as a whole from the instability that could result from bank participation in commerce. The Board believes that these fundamental considerations retain their essential validity and should continue to guide the evolution of banking services in the changing economic and competitive environment that we have today.

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56 Indeed, a complete prohibition against Bank's use of Schwab's brokerage service could conceivably cause a breach of fiduciary duty in a particular case where Schwab in fact can provide the best execution of the order. Moreover, there is no indication that Schwab will not comply with the limitations that the SEC and other authorities have prescribed on the receipt by brokers of funds solely to earn interest. A similar Board-imposed limitation is unnecessary.

57 12 C.F.R. § 225.4(c)(2).

The Board finds that there is no inconsistency between the basic policies of the BHC Act and the conduct of the nonbanking activity that is the subject of this application. As described in detail in this Order, the Board has found that a securities brokerage service that is essentially confined to the purchase and sale of securities for the account of third parties, and without the provision of investment advice to the purchaser or seller, does not raise the potential for conflicts of interest or concentration of resources that were the object of the prohibitions that were instituted to assure the separation of banking from commerce. Expansion of banking into securities activities must proceed carefully, but the proposed activity raises none of the concern that engenders the need for restrictions on banking or bank holding company activities.

Based upon the foregoing and other considerations reflected in the record, the Board has determined that the public benefits associated with consummation of this proposal can reasonably be expected to outweigh possible adverse effects, and that the balance of the public interest factors, which the Board is required to consider under section 4(c)(8) of the Act, is favorable. Accordingly, the application is hereby approved.

This determination is subject to the conditions set forth in section 225.4(c) of Regulation Y and the Board's authority to require such modification or termination of the activities of a holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder, or to prevent evasion thereof.

Because of the extensive consideration accorded to Schwab's securities brokerage, margin lending, and incidental activities in the context of this application, and having determined that the public interest considerations of section 4(c)(8) favor approval of BAC's proposal, the Board has determined that further applications by BAC to extend Schwab's retail discount securities brokerage, margin lending, and incidental activities to additional offices may be processed in the same manner as other *de novo* applications under the provisions of section 225.4(b)(1) of Regulation Y (12 C.F.R. § 225.4(b)(1)). Author-

ity is hereby delegated to the Federal Reserve Bank of San Francisco to take action on such notices properly filed as prescribed in that section.

The proposed activities shall not commence later than three months after the effective date of this Order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco.

By order of the Board of Governors,[58] effective January 7, 1983.

(Signed) James McAfee

James McAfee
Associate Secretary of the Board

[SEAL]

58 Voting for this action: Chairman Volcker and Governors Martin, Wallich, Partee, Rice and Gramley. Absent and not voting: Governor Teeters.

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 83-4019

Argued: May 23, 1983

Decided: July 15, 1983
(as amended September 20, 1983)

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—against—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents,

—and—

BANKAMERICA CORPORATION,

Intervenor.

Appearances

JAMES B. WEIDNER, ESQ., New York, N.Y. (Rogers & Wells, New York, N.Y., John M. Liftin, Esq., Harry M. Yohalem, Esq., David A. Schulz, Esq., Mark Holland, Esq., Bruce E. Braverman, Esq. and Donald J. Crawford, Esq., Washington, D.C., William J. Fitzpatrick, Esq., New York, N.Y., of counsel), for Petitioner Securities Industry Association.

GARY D. WILSON, ESQ., Washington, D.C. (Wilmer, Cutler & Pickering, Washington, D.C., Arnold M. Lerman, Esq., Alan S. Tenenbaum, Esq. and H. Helmut Loring, Esq., William S. MacKay, Esq., Janice Decker, Esq., San Francisco, California, of counsel), for Intervenor BankAmerica Corporation.

RICHARD M. ASHTON, Attorney, Board of Governors of the Federal Reserve System, Washington, D.C. (Michael Bradfield, General Counsel, Kevin J. Handly, Attorney, Board of Governors, Washington, D.C., and J. Paul McGrath, Assistant Attorney General, Civil Division, Department of Justice, Washington, D.C., of counsel), for Respondents Board of Governors of the Federal Reserve System.

ROBERT S. RIFKIND, ESQ., New York, N.Y. (Cravath, Swaine & Moore, New York, N.Y., Stephen S. Madsen, Esq. and Deborah S. Prutzman, Vice President and Counsel, The New York Clearing House Association, New York, N.Y., of counsel), for The New York Clearing House Association, Amicus Curiae.

Before:

FEINBERG, *Chief Judge*,
LUMBARD and WINTER, *Circuit Judges*.

LUMBARD, *Circuit Judge*:

On January 7, 1983 the Federal Reserve Board authorized the BankAmerica Corporation, a bank holding company, to acquire the Charles Schwab Corporation, the sole owner of Charles Schwab & Co., the nation's largest "discount" brokerage firm. The Securities Industry Association (SIA), a national trade association representing over 540 securities brokers,

dealers, and investment banking companies, petitions for judicial review of the Board's order. SIA contends that the acquisition approved by the Board violates both the Glass-Steagall Act and the Bank Holding Company Act. We find, however, that neither of those Acts prohibits a bank holding company from engaging in retail brokerage, and that the Board acted well within its discretion in approving BankAmerica's application. We therefore deny SIA's petition for review and affirm the order of the Board.

The BankAmerica Corporation (BAC), with total assets of $120.5 billion, is the second largest bank holding company in the United States. BAC's most important subsidiary is the Bank of America (Bank) which, with domestic deposits of $52 billion, is the nation's largest commercial bank. Charles Schwab & Co. (Schwab) is principally engaged in retail securities brokerage. Schwab buys and sells securities solely as agent, on the order and for the account of its customers. Schwab offers its brokerage customers incidental services including margin loans, securities custodial services, and "sweep" accounts in which net balances awaiting investment are deposited in a money market fund not affiliated with Schwab. Schwab does not, however, offer its customers investment advice and, with minor exceptions not here relevant, does not underwrite or deal in securities. Schwab and similar firms are called "discount brokers" because the commissions they charge typically are significantly lower than those charged by full-service brokerage firms which offer investment advice. Schwab, headquartered in San Francisco, operates nationwide with offices in 26 states and the District of Columbia. Although, by revenue, Schwab currently holds 9% of the discount brokerage market, it holds less than 1% of the total retail brokerage market.

On March 8, 1982 BAC applied to the Federal Reserve Board for permission to acquire 100% of the stock of Schwab's parent corporation. BAC filed its application under § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1976), which authorizes the Board to approve a bank holding company's acquisition of a subsidiary if the subsidiary's activities are "closely related" to banking and if

the public benefits reasonably to be expected from the acquisition outweigh possible adverse effects. The Board published notice of BAC's application in the Federal Register, 47 Fed. Reg. 16,104 (1982), and requested comments from interested parties. The Antitrust Division of the Department of Justice, the Comptroller of the Currency, and the Securities and Exchange Commission all filed comments in support of the application. SIA opposed the application and requested the Board to conduct a formal hearing. An administrative law judge held an evidentiary hearing in September, 1982, and on November 12, 1982, issued his decision recommending that the acquisition be approved. The judge found the proposed acquisition to be consistent with both the Glass-Steagall Act and the Bank Holding Company Act. On January 7, 1983 the Board adopted the judge's findings and conclusions, with modifications, and authorized BAC to acquire Schwab. 69 Fed. Res. Bull. 105 (1983). SIA petitions for review under 12 U.S.C. § 1848 (1976).

I. *Glass-Steagall Act*

Those provisions of the Banking Act of 1933 that mandated a separation of the commercial and investment banking industries are known as the Glass-Steagall Act. *See* Pub. L. No. 73-66, §§ 16, 20, 21, & 32, 48 Stat. 162 (1933). SIA claims that the Glass-Steagall Act prohibits bank holding company subsidiaries from conducting a retail brokerage business. Although SIA's claim raises an issue of law which we have the ultimate responsibility to decide, *see* 5 U.S.C. § 706 (1976), the Board's thorough opinion rejecting the claim is entitled to substantial deference. Because the Board has both primary responsibility for implementing the Glass-Steagall Act and expert knowledge of commercial banking, we must uphold its interpretation of the Act if it is reasonable. *See Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21 (1981), quoting *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, *J.*, concurring); *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-27 (1971); *A.G. Becker Inc.* v. *Board of Governors*, 693

F.2d 136, 140-41 (D.C. Cir. 1982). We conclude that the Board's interpretation was reasonable and entirely consistent with the Act's language and policy.

Only one of the Glass-Steagall Act's four provisions is directly applicable to bank holding companies. That provision, § 20, 12 U.S.C. § 377 (1976) states:

> [N]o member bank shall be affiliated in any manner . . . with any corporation, association, business trust, or other similar organization *engaged principally in the issue, flotation, underwriting, public sale, or distribution* at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities . . .

(emphasis supplied). As a bank holding company's various subsidiaries are bank affiliates for purposes of § 20, *see* 12 U.S.C. § 221a(b) (1976), BAC's acquisition of Schwab will make Schwab an affiliate of Bank. Section 20 therefore prohibits the acquisition if Schwab is "engaged principally" in any of the activities listed in the statute. Although SIA concedes that Schwab is not engaged in the issue, flotation, underwriting, or distribution of securities, it argues that Schwab's retail brokerage business does constitute the "public sale" of securities.

SIA's interpretation of "public sale" to include brokerage is rebutted by the "familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third Natl. Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977) (footnote omitted). *See also General Elec. Co.* v. *OSHA*, 583 F.2d 61, 65 (2d Cir. 1978). The terms "issue," "flotation," "underwriting," and "distribution" all refer to the widespread marketing of specific issues of new securities in which the dealer trades as principal for his own profit. *See generally* L. Loss, Securities Regulation 159-72 & 547-53 (2d ed. 1961). Such activities greatly differ from retail brokerage, in which the broker trades as an agent for commission, not as a principal for profit, and does not transfer title. Thus if "public sale" is to be given a meaning similar to that of the terms that surround it, it cannot be read to encompass retail brokerage.

Moreover, if Congress had intended § 20 to cover brokerage, it presumably would have used words more precise than "public sale." Section 16 of the Act, 12 U.S.C. § 24(7) (1976), authorizes banks to engage in "purchasing and selling . . . securities and stocks without recourse, solely upon the order, and for the account of, customers." Congress' use in § 16 of language that specifically refers to brokerage,[1] and its omission of similar terms from § 20, suggests that Congress did not intend § 20 to cover brokerage. *See FTC* v. *Sun Oil Co.*, 371 U.S. 505, 514-15 (1963) (terms carefully employed by Congress in one place, and excluded in another, should not be implied where excluded).

The Board's ruling that § 20 does not encompass brokerage is supported by its long-standing interpretation of a different provision of the Glass-Steagall Act, § 32, 12 U.S.C. § 78 (1976). Section 32 prohibits managerial or other interlocks between member banks and any entity primarily engaged in "the issue, flotation, underwriting, public sale, or distribution" of securities. Section 32's list of prohibited activities is precisely that found in § 20. In January, 1936, shortly after the Banking Act of 1935 revised § 32 into its present form, the Board ruled that "[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32." 22 Fed. Res. Bull. 51 (1936). The Board's interpretation of § 32, to which it still adheres, *see* 12 C.F.R. § 218.1 n.1, has been confirmed by the Supreme Court. In *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), two directors of a national bank also worked for a securities firm which derived approximately 32% of its gross income from underwriting, and 42% from brokerage. The Board ruled that the directors' outside firm was "primarily engaged" in activities covered by § 32, and it ordered the directors to resign from the bank. The directors challenged the Board's order in court. The District of Columbia Court of Appeals, by a divided vote, held that an injunction should issue. 153 F.2d 785 (1946). The

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1 The scope of the brokerage activities which § 16 authorizes banks to conduct is open to debate. *See infra*.

majority and dissenting opinions in the Court of Appeals agreed that § 32 does not cover brokerage. 153 F.2d at 790, 795. They disagreed only on the degree of involvement necessary for a firm to be "primarily" engaged in an activity prohibited by § 32. The Supreme Court granted certiorari and reversed. The Court concluded, as had the dissenting judge in the Court of Appeals, that a firm is "primarily" engaged in a prohibited activity if it is "substantially" so engaged, and that the Board's order was therefore lawful notwithstanding the fact that the directors' outside firm earned less than half of its revenue from underwriting. Although the Court did not explicitly rule brokerage to be excluded from § 32, it did distinguish the firm's brokerage income from its underwriting income, and used the language of § 32 to define "underwriting" as the "issue, flotation, underwriting, public sale or distribution" of securities. 329 U.S. at 445 n.3. It thus seems clear that the Court read § 32 to exclude brokerage. Indeed, if the Court had not so read the statute, it would not have had to explore the meaning of "primarily engaged," since the directors' outside employer was, under any interpretation of the term, "primarily engaged" in underwriting and brokerage taken together. Use of the same language in different statutory provisions, where the various provisions were enacted together and concern the same general goals, is a strong indication that Congress intended the language to have the same meaning wherever it appears. *See Northcross* v. *Board of Educ. of the Memphis City Schools*, 412 U.S. 427, 428 (1973); *Hargrave* v. *Oki Nursery, Inc.*, 646 F.2d 716, 720 (2d Cir. 1981). The Board's consistent interpretation excluding brokerage from § 32 is thus, especially in view of *Agnew*, strong evidence that brokerage is excluded from § 20.[2]

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2 Also significant is the Supreme Court's comment in *Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 58 n.24 (1981), that § 20 prohibits bank ownership of securities affiliates that are engaged principally "in the issuance or underwriting of securities." The Court's failure to include "brokerage" in the list of activities covered by § 20 is a further suggestion that brokerage is excluded from the statute.

The policies behind the Glass-Steagall Act shed further light on the proper interpretation of § 20. Congress intended the Act to address two principal concerns. First and foremost, Congress believed that commercial bank involvement in underwriting and securities speculation had unduly placed bank assets at risk and had contributed to "the widespread bank closings that occurred during the Great Depression." *Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 61 (1981) (footnote omitted). Securities trading had impaired bank solvency not only directly through bad investments by banks, but also indirectly through the unsound banking practices that securities trading promoted. In particular, Congress recognized that a bank trading for its own account has a "salesman's interest" that is inconsistent with the traditional role of banks as impartial extenders of credit. A bank seeking to sell the stock of a particular company might, for example, extend customers credit to be used for purchase of the stock or might grant the company an unsound loan simply to improve the stock's marketability. *See Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 631 (1971). Similarly, a bank that engages in trading through a securities affiliate might improperly extend credit to the affiliate, or to companies in which the affiliate invested, in order to avoid the loss in public confidence it would experience if the affiliate failed. Securities trading further shakes public confidence in banks because it associates banks with speculative ventures, and because some customers purchasing securities on bank representations will inevitably suffer losses. This loss of public confidence poses an additional threat to bank solvency. *See id.*, 401 U.S. at 631-32. Thus in strictly limiting the right of commercial banks to trade in securities, Congress sought to ensure bank solvency, to protect bank depositors, and to maintain public confidence in the nation's banks. Second, Congress recognized the inherent conflict between the promotional role of an investment banker and the commercial banker's obligation to give disinterested investment advice. A commercial bank that trades as a principal might allow its interest in trading profits to override the fiduciary duties owed to depositors. *See id.*, 401 U.S. at 633. Congress thus intended

the Glass-Steagall Act to guarantee that the impartiality of investment advice would not be "tainted by a desir to profit from the promotion of one particular security over another." Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L.J. 102, 104 (1981) (footnote omitted).

Schwab's brokerage services do not present any of the dangers which the Glass-Steagall Act was designed to forestall. Because Schwab trades only as an agent, and never as a principal, its assets are not subject to the risks of the securities markets. Equally important, Schwab's lack of a "salesman's interest" in the securities it trades eliminates the incentive for the Bank to engage in promotional activities. Schwab's revenue depends solely on the volume of shares traded, and is not dependent upon the sale or purchase of specific securities. Thus the Bank cannot increase Schwab's profits by extending credit to securities issuers to bolster their stock or to purchasers for the purchase of specific shares, or by improperly favoring particular securities in its management of customers' assets. Although Schwab and the Bank will be associated with one another in the public eye, the losses that some customers will sustain on trades executed through Schwab will be unlikely to impair public confidence in the Bank. Given Schwab's strict policy not to offer investment advice, customers who trade unsuccessfully will have only themselves, and not Schwab or the Bank, to blame for their mistakes.

The Act's legislative history and Supreme Court precedent support our interpretation of the Act's focus. First, the legislative history, though it discusses at length the dangers posed by commercial bank involvement in underwriting and securities speculation, *see, e.g.*, S. Rep. No. 77, 73d Cong., 1st Sess. 8-10 (1933), makes but passing reference to bank brokerage activity. The Senate report states only that the Act allows banks to "purchase and sell investment securities for their customers to the same extent as heretofore." *Id.* at 16. This statement hardly suggests that brokerage was one of Congress' principal concerns. Second, in *Investment Co. Inst.* v. *Camp*, *supra*, the Supreme Court drew a clear distinction between brokerage and activities in which a bank trades as a principal. In *Camp*, the

Court held that a bank's plan to distribute shares in a bank-managed open-end investment fund would constitute an impermissible underwriting of securities in violation of § 16 of the Act. The Court emphasized that the bank would have a salesman's stake in the fund's shares, and thus would have an incentive to engage in promotional activities contrary to the Act's policy. The Court contrasted the bank's plan with brokerage services, and stated that the hazards associated with promotional activities "are not present when a bank undertakes to purchase stock for the account of its individual customers." 401 U.S. at 638. The Court stated that purchases on account "do not give rise to a promotional or salesman's stake in a particular investment; . . . do not entail a threat to public confidence in the bank itself; . . . and do not impair the bank's ability to give disinterested service as a fiduciary or managing agency." *Id.* The Court's comments, though dicta, strongly suggest that Congress did not intend § 20 to prohibit bank affiliates from engaging in retail brokerage. *See also New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091, 1099-1100 (D.D.C. 1975) (bank's plan to purchase securities on account for customers, and automatically to deduct designated purchase amount from customers' bank accounts, held to be consistent with the Act), *vacated on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

We thus find the Board's ruling to be supported by both the language of § 20 and the Act's policy. SIA argues, however, that § 20's true meaning cannot be found without reference to § 16 of the Act, 12 U.S.C. § 24(7) (1976), which defines the extent to which commercial banks may trade in securities. Section 16 states, in pertinent part, that:

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account.

Although SIA concedes, as indeed it must, that § 16 is directly applicable only to banks, and not to bank holding companies, *see Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46,

58 n.24 (1981), it argues that §§ 16 and 20 must be interpreted "consistently," and cannot be read to permit bank holding companies a broader degree of brokerage activity than is allowed to banks. SIA contends that § 16 does not authorize banks to conduct retail brokerage businesses such as Schwab's. SIA's position is supported by certain early rulings by the Comptroller of the Currency which held that § 16 authorizes a bank to engage in brokerage only if (1) the customer has a customer relationship with the bank independent of the brokerage transaction, (2) the bank offers its brokerage services at cost, and (3) the customer makes prior payment or has assets at the bank sufficient to cover his transaction. *See e.g.*, 1 Bulletin of the Comptroller of the Currency, No. 2 at 2-3 (1936). Relying principally upon the Comptroller's rulings, SIA argues that banks may engage in brokerage only to accommodate existing customers, and that the principal brokerage activities of bank holding companies must, under a consistent interpretation of the Act, be similarly limited.

The proper interpretation of § 16 is before us only incidentally, and we do not think it necessary to explore the question in detail. Instead, three considerations convince us that SIA's attempt to transfer the focus of this case from § 20 to § 16 is unavailing. First, the Comptroller of the Currency recently reversed the rulings upon which SIA relies. In *Security Pacific Natl. Bank*, [Current] Fed. Bank. L. Rep. ¶ 99,284 (CCH) (1982), the Comptroller held that § 16 authorized a national bank to establish a subsidiary that would offer discount brokerage services to the public but would not offer investment advice. The Comptroller stated that his earlier restrictive rulings reflected "the great caution of banking regulations in the years immediately following the 1931-32 debacle," and were not supported by either the purposes or the express language of the Glass-Steagall Act. Because we agree with the Comptroller that the Act's policies are not contravened by bank participation in retail brokerage, we are inclined to give significant weight to the Comptroller's repudiation of his earlier rulings.[3]

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3 SIA has brought an action in the District Court for the District of Columbia challenging the Comptroller's ruling in *Security Pacific*

Second, SIA has not convincingly explained why §§ 16 and 20, notwithstanding Congress' use of very different language in the two provisions, must be interpreted alike. If, as SIA contends, Congress intended in §§ 16 and 20 significantly and equivalently to restrict the brokerage activities of banks and bank holding companies, it presumably would have used the same, or at least similar, language in both statutes. Finally, the structure of the Act "reveals a congressional intent to treat banks separately from their affiliates," *Investment Co. Inst.*, *supra*, 450 U.S. at 59 n.24, and clearly indicates that the same prohibitions do not apply to both. Banks, for example, under § 16 can never underwrite or deal in the securities of private issuers, while bank holding companies, under § 20, can engage in such underwriting and dealing so long as they are not principally so engaged. SIA argues that this distinction between §§ 16 and 20 is unimportant; that the same *types* of activities are prohibited to banks and to bank holding companies; and that bank holding companies, even if they can partially engage in certain activities totally barred to banks, cannot principally engage in such activities. SIA thus concludes that § 20 at most authorizes Schwab minimally to engage in retail brokerage, and does not allow it to make brokerage a principal line of business. We think, however, that the latitude the Act grants bank holding companies partially to engage in activities such as underwriting, which implicate the Act's policies whether conducted by banks or by bank holding companies, suggests that bank holding companies can, under the Act, be allowed principally to engage in activities which pose the dangers the Act addressed only when conducted by banks. Congress clearly intended the Act to restore banking as the principal business of banks, and may have believed (though we see no support for the point in the legislative history) that banks would be unreasonably diverted from banking by participation in retail brokerage. But even if Congress, because of

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Natl. Bank. Securities Industry Assoc. v. *Conover*, No. 82-2865 (D.D.C. filed October 6, 1982). What we say here is not meant to express an opinion on the validity of the Comptroller's ruling.

such concerns, restricted in § 16 the brokerage activities allowed to banks, no similar danger of diversion is posed by the brokerage activities of bank holding companies. Thus even if § 16 prohibits banks from acting as retail brokers, we would have to conclude, in light of (1) the statutory language and policy considerations previously discussed and (2) the Act's clear intent to "treat banks separately from their affiliates," that Congress did not intend § 20 to prohibit bank holding companies from acquiring or establishing brokerage subsidiaries.[4]

II. *Bank Holding Company Act*

The Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.* (1976), generally prohibits bank holding companies from engaging in nonbank activities. However, section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), provides that a bank holding company may acquire:

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4 SIA also argues that the Board's order contravenes the provision of § 16 that limits national banks to "purchasing and selling such securities and stock without recourse. . . ." SIA contends that Schwab trades "with recourse" because brokerage customers occasionally "walk away" from trades that prove unprofitable within the settlement period, leaving Schwab liable to the third party to the transaction for the purchase price or for delivery of the security. Beyond the fact that SIA has not convinced us to incorporate § 16's language into § 20, we do not think that Schwab's activities violate § 16 merely because it faces the kind of incidental liability to which SIA refers. The Supreme Court's decision in *Awotin* v. *Atlas Exchange Natl. Bank of Chicago*, 295 U.S. 209, 212 (1935) (holding that a repurchase agreement between the bank and one who bought bonds from it was void as a violation of § 16), strongly suggests that the limitation in § 16 is directed against endorsement or guaranty contracts "by which the bank assumes the risk of loss which would otherwise fall on the buyer of securities, or undertakes to insure to the seller the benefit of an increase in value of securities which would otherwise accrue to the Bank." Schwab does not enter into contracts that obligate it to "assume" ultimately its brokerage customers' risks; on the contrary, it retains full power to bring actions for breach of contract against customers who fail to pay for or deliver securities.

> shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Section 4(c)(8) further provides that:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern.

Section 4(c)(8) authorizes the Board to approve a bank holding company's acquisition of a nonbank subsidiary only if it determines that (1) the subsidiary's activities are "closely related" to banking, and (2) the public benefits reasonably to be expected from the acquisition will outweigh possible adverse effects. *See* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. (1970) *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5572-73. *See, e.g., Independent Ins. Agents of America, Inc.* v. *Board of Governors*, 658 F.2d 571, 573 (8th Cir. 1981); *Citicorp* v. *Board of Governors*, 589 F.2d 1182, 1190 (2d Cir.), *cert. denied*, 442 U.S. 929 (1979); *National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1232-33 & n.2 (D.C. Cir. 1975). SIA challenges the Board's ruling that BAC's acquisition of Schwab satisfies both of these requirements.

Section 4(c)(8) and its legislative history do not identify the factors the Board is to consider in determining which activities are closely related to banking. However, in *National Courier*

Assn., *supra*, 516 F.2d at 1237, the District of Columbia Court of Appeals held that the Board may treat any activity as one closely related to banking if there is present one or more of the following connections between the activity and the business of banking:

> 1. Banks generally have in fact provided the proposed services.
>
> 2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> 3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

Although the factors listed in *National Courier Assn.* do not exhaust the possible connections which could establish a close relationship between a proposed activity and banking, *see id.*, they do usefully elucidate the closely related standard and have been employed by several of the courts of appeals, *see NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549 (7th Cir. 1978); *Alabama Assn. of Ins. Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), and by the Board. *See, e.g.*, *Citicorp*, 68 Fed. Res. Bull. 505 (1982).

In this case the Board, relying upon the second of the *National Courier Assn.* factors, held that the present securities activities of banks are operationally or functionally so similar to brokerage that banks are particularly well equipped to act as retail brokers. The Board found that many banks, as an accommodation to their customers, transmit to brokers customer orders to buy or sell securities, and that the trading desks of bank trust departments routinely buy and sell securities as agents for trusts and other accounts. The Board noted one principal difference between the securities activities of brokerage houses and of banks: brokerage houses trade listed

securities directly on the exchanges, while banks historically have employed intervening brokers to execute such trades, but it concluded that banks nonetheless have expertise in the methods of securities trading. The Board found that banks, when trading unlisted securities, often deal directly with dealers or other third parties, and that such trades require banks to "exercise the same type of discretion and judgment with respect to the best method of execution that brokers do with respect to similar types of orders." The Board further found that when banks employ intervening brokers, they often direct the broker on the best method of execution, and leave to the broker only the technical execution of the transactions. Finding that banks widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading, the Board held that retail brokerage is an activity closely related to banking.

The Board's factual findings are conclusive if supported by substantial evidence, 12 U.S.C. § 1848, and the Board's findings on bank trading activities are clearly so supported. SIA, however, argues that the Board misapprehended the legal standard implicit in the closely related test. SIA claims that an activity is closely related to banking only if it facilitates actual banking practices[5] and can be conducted by most of the

5 As enacted in 1956, § 4(c)(8) (then § 4(c)(6)) authorized bank holding companies to engage in activities "of a financial, fiduciary, or insurance nature . . . which the Board . . . has determined to be so closely related to *the business of banking* . . . as to be a proper incident thereto." Pub. L. No. 511, § 4(c)(6), 70 Stat. 137 (1956). The Board interpreted the phrase, "the business of banking," to prohibit bank affiliation with any company whose activities were not directly related to the banking operations that the particular holding company was already engaged in. Congress in 1970 deleted the words "the business of" in order to make it clear that the acquired company's activities need not be closely related to the acquiring holding corporation's specific banking business, but only to banking generally. *See* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5567; *National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1236 (D.C. Cir. 1975). SIA thus argues that § 4(c)(8) required the Board to find that retail brokerage facilitates banking generally, and does not argue that facilitation of BAC's particular banking operations is required.

nation's banks. SIA argues that brokerage does not satisfy either of those requirements, and is therefore not closely related to banking. We do not agree.

SIA's challenge to the Board's legal conclusion must be evaluated in light of the deference ordinarily due to Board determinations under § 4(c)(8). Congress has committed to the Board primary responsibility for the administration of the Act. The Board, moreover, has expertise in commercial bank regulation that the courts do not have, and it must be allowed reasonable latitude in its application of the Act to the changing activities of banks. For these reasons the Board's determination that brokerage is closely related to banking "is entitled to the greatest deference," *Investment Co. Inst., supra,* 450 U.S. at 56 (footnote omitted), and may be overturned only if unreasonable or inconsistent with Congressional intent. *See National Courier Assn.* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975). We see nothing in SIA's arguments that would justify reversal of the Board's order under this standard of review.

SIA's claim that an activity must facilitate actual banking practices to be closely related to banking is, we think, refuted by the Supreme Court's decision in *Investment Co. Inst., supra.* In *Investment Co. Inst.*, the Supreme Court upheld a Board regulation issued under § 4(c)(8) that authorized bank holding company subsidiaries to serve as investment advisers to closed-end investment companies. An investment company offers small investors portfolio diversification and expert management by pooling their resources under the guidance of one manager. Investment advisers are independent of the investment companies they advise. In return for a management fee, an investment adviser selects the investment company's portfolio and supervises most aspects of its business. In affirming the Board's determination that investment advisory services are closely related to banking, the Court emphasized that such services "are not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. The Court stated that the principal duty of an investment adviser is to manage the investment portfolio of its client, and noted that

banks, in their roles as executors, trustees, and managing agents, have for decades provided equivalent management services to bank customers. *Id.* The Court's analysis thus focused upon the relationship of investment advisory services to services traditionally performed by banks. The Court upheld the Board's regulation because the proposed activity constituted, in effect, the provision in a nonbanking context of services that banks have traditionally offered their customers. The Court never considered whether investment advisory services provided to nonbank investment companies facilitate actual banking practices, and it seems quite clear that they do not. Thus both the result reached in *Investment Co. Inst.*, and the analysis the Court employed, indicate that an activity need not facilitate banking practices to be closely related to banking.

SIA also contends that an activity, to be closely related to banking, must be open to most banks. SIA argues that only the largest banks have the skills and resources needed to engage in retail brokerage; that banks *generally* will not be able to enter the brokerage business; and that brokerage is therefore not closely related to banking. SIA's argument ignores the Board's express finding "that the use of sophisticated techniques, resources and personnel to execute orders for the purchase or sale of securities for the account of customers is sufficiently widespread in the banking industry to justify a finding that banks generally provide securities execution services that equip them to offer the type of retail brokerage services provided by Schwab." In any event, even if the Board had found to the contrary, we could not accept SIA's conclusion. The closely related standard does not require proof that banks generally will be able to perform the proposed service, but instead principally concerns whether the proposed service is functionally related to the traditional services banks generally have performed. The interpretation SIA gives the Act would effectively preclude the nonbank affiliates of bank holding companies from providing financial services not open to the smallest banks. We see nothing in the legislative history to suggest that Congress intended the closely related standard so greatly to

restrict innovation in the financial industry. *Cf.* H.R. Conf. Rep. No. 1747, *supra*, 1970 U.S. Code Cong. & Ad. News at 5568 ("One of the asserted justifications for permitting bank holding companies to engage in activities that the Board has determined independently to be closely related to banking, is to permit the introduction of new innovative and competitive vigor into those markets which could benefit therefrom."). An inability of banks generally to engage in a proposed activity may, of course, raise questions of competitive effect or undue concentration of resources, but such questions are appropriately resolved under § 4(c)(8)'s public benefits test and not under the closely related standard.

Finally, SIA challenges the Board's determination that the public benefits reasonably to be expected from BAC's acquisition of Schwab will outweigh the possible adverse effects. We see no basis for disturbing the Board's conclusion. As the Fifth Circuit has recognized, *see Alabama Assn. of Ins. Agents*, *supra*, 533 F.2d at 246, Board determinations under the public benefits test necessarily involve some speculation, and should be upheld if reasonable. The Board's ruling here plainly is reasonable.[6] SIA further argues that the Board erred in failing

6 The Board found that a number of public benefits are likely to result from BAC's acquisition of Schwab. The Board found that the acquisition will strengthen Schwab as a competitor by affording it access to BAC's managerial, financial, and technical resources. Noting that Schwab competes primarily on the basis of price, the Board stated that the strengthening of Schwab could induce full-line brokers to engage in greater price competition. The Board found that Schwab's affiliation with BAC, a large, internationally-known financial services company, should increase public confidence in Schwab and in discount brokers generally. Because discount brokers have been hampered by a lack of public awareness and acceptance of their services, increased public confidence in discount brokers should enhance their ability to compete against better-known firms. Finally, the Board found that Schwab's affiliation with BAC will increase consumer convenience. For example, Schwab offices operated at branches of the Bank will reduce consumer search costs by enabling consumers to obtain a broader range of financial services at a single location than is now possible. The Board found that the acquisition is unlikely to have any significant adverse effects, such as undue concentration of resources, decreased competition, or unfair competitive practices.

to require de novo entry by BAC into the retail brokerage business. Section 4(c)(8) states that in orders under the statute "the Board *may* differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern." (emphasis supplied). Congress included this language in § 4(c)(8) because it believed that de novo entry generally has greater procompetitive effect than does entry through the acquisition of an existing competitor. *See* S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5519, 5534; H.R. Conf. Rep. No. 1747, *supra*, 1970 U.S. Code Cong. & Ad. News at 5568. SIA argues that, because many of the benefits expected to result from BAC's acquisition of Schwab could equally be achieved through de novo entry by BAC into retail brokerage, the Board must require de novo entry. We do not agree. Congress did not favor de novo entry as a goal in itself, but as a means of maximizing the procompetitive effects of activities conducted under § 4(c)(8). Here, the Board found that BAC's acquisition of Schwab will not substantially lessen competition, and will likely produce public benefits that outweigh possible adverse effects. Where, as here, entry by acquisition promotes competition as effectively as would de novo entry, and involves no significant anticompetitive effects that de novo entry would avoid, the Board has discretion to permit entry by acquisition.

The petition for review is denied; the order of the Board is affirmed.

RELEVANT PROVISIONS OF THE BANKING ACT OF 1933 (THE GLASS-STEAGALL ACT)

SECTION 5(c):

12 U.S.C. § 335. Dealing in Investment Securities; Limitations and Conditions

State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph "Seventh" of section 24 of this title.

SECTION 16:

12 U.S.C. § 24. Corporate Powers of Associations

Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * *

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency

may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, co-partnership, association or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or . . .

SECTION 20:

12 U.S.C. § 377. Affiliation with Organization Dealing in Securities; Penalties

After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

SECTION 21:

12 U.S.C. § 378. Dealers in Securities Engaging in Banking Business; Individuals or Associations Engaging in Banking Business; Examinations and Reports; Penalties

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities,

to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this paragraph shall not prohibit national banks or state banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: *Provided further*, That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate;

* * *

SECTION 32:

12 U.S.C. § 78. Certain Persons Excluded from Serving as Officers, Directors or Employees of Member Banks

No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

RELEVANT PROVISIONS OF THE BANK HOLDING COMPANY ACT

12 U.S.C. § 1843. Interests in Nonbanking Organizations

Ownership or control of voting shares of any company not a bank; engagement in activities other than banking.

(a) Except as otherwise provided in this Act no bank holding company shall—

(1) after the date of enactment of this Act [enacted May 9, 1956], acquire direct or indirect ownership or control of any voting shares of any company which is not a bank,

* * * * * *

(c) Exemptions. The prohibitions in this section shall not . . . apply to—

* * * * * *

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

No. 83-614

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, PETITIONER

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly upheld the decision of the Federal Reserve Board that neither the Bank Holding Company Act, 12 U.S.C. 1841 *et seq.*, nor provisions of the Glass-Steagall Act, 12 U.S.C. 24, 377, 378, prohibit a bank holding company from acquiring a nonbank subsidiary that is engaged in discount securities brokerage services.

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BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 716 F.2d 92. The order of the Board of Governors of the Federal Reserve System (Pet. App. 21a-52a) is reported at 69 Fed. Res. Bull. 105. The Recommended Decision of the administrative law judge is not reported.

JURISDICTION

The judgment of the court of appeals was entered on July 15, 1983, and amended on September 20, 1983. The petition for a writ of certiorari was filed on October 13, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. Section 20 of the Banking Act of 1933 (the Glass-Steagall Act, 12 U.S.C. 377) and Section 4 of the Bank Holding Act of 1956 (12 U.S.C. 1843) are reproduced at Pet. App. 54a, 56a.

STATEMENT

1. On March 8, 1982, BankAmerica Corporation ("BAC"), a bank holding company within the meaning of the Bank Holding Company Act, 12 U.S.C. 1841(a)(1), applied to the Federal Reserve Board under Section 4(c)(8) of the Act, 12 U.S.C. 1843 (c)(8), for permission to acquire The Charles Schwab Corporation, and its wholly-owned discount brokerage subsidiary, Charles Schwab & Co., Inc. (Schwab).[1] Under BAC's proposal, Schwab would remain a separately incorporated broker, registered with the Securities and Exchange Commission. 15 U.S.C. 78o.

The Board published notice of BAC's application and requested comments. 47 Fed. Reg. 16104 (1982). In response, petitioner objected to the proposed acquisition and requested a formal hearing on BAC's application.[2] The request was granted by the

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[1] "Discount" brokers offer "bare-bones" transactional services—they arrange purchases and sales of securities solely as agents, upon the order and for the account of their customers, and do not offer investment research or advice. Discount brokers compete primarily on the basis of price, and are distinguished from their "full-line" competitors by lower commission rates (Pet. App. 3a).

[2] Comments on BAC's application were received from 99 sources. The Securities and Exchange Commission, the Comptroller of the Currency, and the Department of Justice all submitted comments favoring the proposal.

Board and extensive hearings were held in September 1982, before an administrative law judge (Pet. App. 22a).

On November 12, 1982, the administrative law judge issued a 164-page Recommended Decision recommending that the Board approve BankAmerica's application (C.A. App. A387-A557). In turn, the Board adopted the findings and conclusions of the administrative law judge in all material respects and approved BAC's application (Pet. App. 21a-52a). Applying the standards articulated in *National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975), to the extensive hearing record compiled with regard to the application, the Board concluded (Pet. App. 25a-27a, 50a-51a) that Schwab's discount securities brokerage services are "so closely related to banking * * * as to be a proper incident thereto" within the meaning of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). This conclusion was based on the Board's findings that banks have traditionally and routinely purchased and sold stock and other securities as agent for their trust accounts, as well as for individual customers on an accommodation basis and, accordingly, banks are well-equipped to perform such services for the public (Pet. App. 25a-27a). In addition, as required by Section 4(c)(8), the Board found that BAC's proposed acquisition of Schwab could reasonably be expected to produce significant public benefits in the form of increased competition, convenience and efficiency in the provision of retail brokerage services, and would cause no significant adverse effects (Pet. App. 29a-42a). Finally, the Board concluded (Pet. App. 43a-47a) that since Schwab purchases and sells securities only in the sec-

ondary market as agent for retail customers and not for its own account, Schwab is not engaged in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, and therefore BAC's proposed acquisition did not contravene that provision.

3. The court of appeals affirmed the Board's order (Pet. App. 1a-20a). On the issue of the meaning of Section 20 of the Glass-Steagall Act, the court of appeals upheld the Board's conclusion that Schwab's brokerage services do not, as petitioner had contended, constitute the "public sale" of securities (Pet. App. 4a-13a). In so holding the court relied heavily upon the Board's longstanding construction of identical language in Section 32 of the Act, 12 U.S.C. 78, as excluding brokerage activities. The court likewise rejected petitioner's contention that Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, which limits a national bank to "purchasing and selling" securities "without recourse" upon the order and for the account of customers, and not for its own account, implicitly imposed restrictions on bank affiliates identical to those it expressly imposed on banks (Pet. App. 11a-13a).

The court also upheld as "clearly" supported by substantial evidence the Board's findings that banks "widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading" (Pet. App. 16a). Accordingly, the court concluded that the Board properly held that Schwab's brokerage activities satisfy the "closely related" test of Section 4(c)(8) of the Bank Holding Company Act (Pet. App. 16a). The court rejected petitioner's contention that a nonbank activity must "facilitate" banking operations and be open to all banks in order

to satisfy the "closely related" test of Section 4(c)(8) (Pet. App. 17a-19a).

ARGUMENT

1. Petitioner argues (Pet. 10-14) that the Board and the court of appeals erred in holding that the "closely related" standard in Section 4(c)(8) of the Bank Holding Company Act permits a holding company to acquire a nonbank subsidiary that engages in activities that are "functionally so similar" to activities undertaken by banks, that banks are particularly well equipped to provide the proposed service. Petitioner asserts that, on the contrary, Congress intended to bar holding companies from acquiring any subsidiaries whose activities do not bear a "direct and significant" connection with banking. Pet. 12 (quoting, *Bank Holding Company Act Amendments: Hearings Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. 199 (1969)).[3]

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[3] Petitioner's present contention that Section 4(c)(8) requires a "direct and significant" or "operational" connection between the proposed activities and banking (Pet. 12, 13) appears to be little, if anything, more than a verbal reformulation of the "facilitation" argument rejected by the court of appeals. In any event, the "direct and significant connection" reference was derived from an interpretation of Section 4(c)(8) prior to its amendment in 1970. Prior to 1970, Section 4(c)(6) authorized bank holding companies to engage in nonbank activities "of a financial, fiduciary, or insurance nature" determined by the Board to be "so closely related to *the business of* banking * * * as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act." 70 Stat. 137. The Board interpreted this language as requiring a "direct and significant connection between the proposed activities * * * and the business of banking * * * as conducted by the bank holding company or its banking subsidiaries." *Bank Holding Company Act Amendments: Hearings Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess. 196, 199 (1969) (testi-

Every court of appeals that has interpreted Section 4(c)(8), however, has approved the operational or functional similarity test first announced in *National Courier Ass'n v. Board of Governors, supra*, and subsequently embraced by the Board, *e.g. NCNB Corp.*, 64 Fed. Res. Bull. 506, 507 (1978). See Pet. App. 15a; *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976). Moreover, that standard is perfectly consistent with the reasoning of this Court in *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 55 (1981), in upholding a regulation under Section 4(c)(8) allowing holding companies to acquire nonbanking subsidiaries that serve as investment advisers to closed-end investment companies. The Court held that such investment advice activities were closely related to banking because they were "not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. It seems fairly clear that if this Court had concluded that there must

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mony of Hon. William McChesney Martin, Jr.); see also *One-Bank Holding Company Legislation of 1970: Hearings Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 139, 141 (1970) (testimony of Hon. Arthur F. Burns). At the Board's request, Congress deleted the words "the business of" from Section 4(c)(8) in 1970 to make it clear "that a nonbank subsidiary's activities should be related to banking * * * generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved." See Letter from Hon. Arthur F. Burns to Hon. Wright Patman (Nov. 23, 1970), *reprinted in* 116 Cong. Rec. 41959 (1970) (remarks of Rep. Widnall); 116 Cong. Rec. 42433, 42434 (1970) (remarks of Sen. Bennett); H.R. Rep. 91-1747, 91st Cong., 2d Sess. 16 (1970). See *National Courier Association*, 516 F.2d at 1236 & n.14.

be a "direct and significant" or "operational" connection between the affiliate activities and banking in order for a holding company to acquire the nonbanking subsidiary, the regulation allowing the acquisition of investment advisers would not have been upheld. Accordingly, the court of appeals plainly applied the proper legal standard in deciding whether the Bank Holding Company Act prohibited this acquisition and the only issue is whether it applied that standard correctly.

In that regard, petitioner's only claim (Pet. 18-19) is that the approval of this acquisition by the court of appeals is inconsistent with a Fifth Circuit decision rejecting a portion of a Board regulation allowing the acquisition of nonbanking subsidiaries that engage in certain insurance brokerage activities. *Alabama Ass'n of Insurance Agents* v. *Board of Governors, supra.*[4] But the two cases are readily distinguishable on their facts. In rejecting the Board's finding that the sale of all types of insurance for a bank holding company and its subsidiaries is closely related to banking, the Fifth Circuit found that there was no evidence of any general practice by banks to broker insurance for themselves in any way that was " 'functionally' or 'integrally' related" to the insurance activities of the nonbank subsidiaries. 533 F.2d at 241. The court found that the only relationship between banks and insurance brokerage generally was

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[4] Petitioner asserts (Pet. 19) that the Fifth Circuit in *Alabama Ass'n of Insurance Agents* v. *Board of Governors, supra,* rejected the "functional or operational similarity" analysis employed below. But this claim is manifestly wrong. The Fifth Circuit expressly quoted the *National Courier Ass'n* standards with approval and merely concluded that portions of the Board's insurance regulation did not satisfy those standards. 533 F.2d at 241.

that banks, like any other business, need to be insured. *Ibid.* In this case, the Board and the court found on the basis of evidence that was both substantial and undisputed that the activity at issue here—purchasing and selling stocks and other securities as agent, upon the order and for the account of customers—is one that banks have performed for decades and in which national banks are expressly authorized to engage to at least some extent by Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh (Pet. App. 15a-16a, 25a-28a). Cf. *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 55 (1981) ("As executor, trustee, or managing agent of funds committed to its custody, a bank regularly buys and sells securities for its customers".).[5] Accordingly, the Fifth Circuit's conclusion that certain types of insurance activities were not " 'functionally' or 'integrally' related" to activities undertaken by banks is

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[5] The Board found that Schwab's securities brokerage activities differ from the traditional trading activities of banks only in that Schwab maintains seats on national securities exchanges and executes trades in listed securities on the floors of such exchanges, whereas banks traditionally have not held seats on an exchange and have employed intervening brokers for floor execution (Pet. App. 25a). The Board also found, however, that banks often execute their customers' securities trades in the over-the-counter market, and in doing so use the same techniques, employ personnel with the same training, and utilize the same equipment that Schwab does in executing similar transactions (*id.* at 25a-26a). In addition, the Board found that in selecting and directing floor brokers to execute trades in listed securities, banks often instruct the executing broker as to the best method of execution, leaving to the broker only the ministerial task of effecting the transaction in accordance with the bank's instructions (*ibid.*). The court below concluded that these findings were "clearly" supported by substantial evidence (Pet. App. 16a).

in no way inconsistent with the holding that providing discount brokerage services is "closely related to banking." There is therefore no reason for this Court to review the court of appeals' decision that BAC's application to acquire Schwab is permissible under Section 4(c)(8) of the Bank Holding Company Act.

2. Petitioner argues (Pet. 14-18) that the Board's approval of BAC's application to acquire Schwab is inconsistent with Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which provides:

> [N]o member bank [of the Federal Reserve System] shall be affiliated * * * with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities * * *.

Specifically, petitioner asserts that Schwab is engaged principally in the "public sale" of securities. This contention is without merit.

Petitioner's claim is not predicated on anything in Section 20, itself, but rather on its view of how Section 20 should be interpreted in light of Section 16 of the Glass-Steagall Act, 12 U.S.C. 24, which regulates the activities of banks as opposed to bank holding companies. Petitioner's desire to ignore the language of Section 20 is readily understandable. Section 20 does not by its terms refer to "brokerage," and the execution of orders to buy and sell securities solely as agent for customers does not fall within the commonly accepted meaning of "public sale," which in context implies the widespread marketing of new securities by dealers trading as principals for their own profit. See L. Loss, *Securities Regulation* 159-172 (2d ed. 1961). Moreover, since 1936 the Board

has consistently interpreted identical language in Section 32 of the Glass-Steagall Act, 12 U.S.C. 78 (also applicable to bank affiliates), as excluding public securities brokerage.[6] This Court accepted and employed the Board's construction of Section 32 in *Board of Governors* v. *Agnew*, 329 U.S. 441, 445-446 & n.3 (1947)[7] and has consistently recognized the distinction drawn by the Glass-Steagall Act between underwriting and brokerage activities. *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 63, 66 n.37; *Investment Company Institute* v. *Camp*, 401 U.S. 617, 638 (1972).

Nor is there any basis for modifying the plain and settled meaning of Section 20 because of the very different language and purpose of Section 16. In *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 58, this Court recognized that Section 16 "appl[ies] only to banks and not to bank holding companies." 450 U.S. at 58, n.24.[8] There is

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[6] See Regulation R, 22 Fed. Res. Bull. 51 (1936), codified at 12 C.F.R. 218.1 n.1.

[7] In *Agnew*, this Court upheld the Board's determination that a securities firm was "primarily" engaged in the activities described in Section 32 of the Act even though less than half of the firm's revenues were derived from "underwriting" activities. As the court of appeals here noted (Pet. App. 7a), this Court would have had no occasion to interpret the term "primarily" had it considered the firm's brokerage activities to be within the scope of the statutory language.

[8] In arguing that those sections should be interpreted as imposing identical restrictions on banks and bank affiliates, petitioner ignores the differences in the language of Sections 16 and 20. Section 16 of the Act, applicable to national *banks*, provides in pertinent part, 12 U.S.C. 24 Seventh:

> The business of dealing in securities and stock by the [national bank] association shall be limited to purchasing

simply no basis for incorporating Section 16's restrictions on national banks into Section 20, where Congress obviously intended "that a bank affiliate may engage in activities that would be impermissible for the bank itself." 450 U.S. at 64. The decision below rejecting petitioner's contention is correct and conflicts with no decision of any other court; it therefore does not warrant further review.[9]

> and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

Nowhere does Section 16 mention public sales. Indeed, by its terms, the statute authorizes banks to purchase and sell "securities and stock" upon the order and for the account of customers.

[9] Petitioner suggests (Pet. 6-10) that this decision warrants review because it is part of a pattern of efforts by other agencies of the federal government to alter their regulatory practices relating to the banking industry. But, as petitioner admits (Pet. 10), the decision here does not involve the same legal issues as those regulatory decisions. If the government's regulatory efforts in other spheres are not supported by statutory authority, they will be subject to judicial review, if necessary, in this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Board of Governors of the Federal Reserve System

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No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

BRIEF OF RESPONDENT BANKAMERICA CORPORATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

The Federal Reserve Board approved the application of a bank holding company to acquire a securities brokerage firm which acts as agent in arranging for the purchase and sale of securities by customers. The petition raises two issues:

1. Did the Court of Appeals correctly uphold the decision of the Board that the acquired firm's brokerage services are closely related to banking within the meaning of the Bank Holding Company Act because banks have traditionally performed these services and are particularly well equipped to do so?

2. Did the Court of Appeals correctly uphold the decision of the Board that Section 20 of the Glass-Steagall Act, which prohibits the affiliation of Federal Reserve member banks with investment bankers, does not prohibit affiliation with this brokerage firm?

RULE 28.1 STATEMENT

BankAmerica Corporation owns, directly or indirectly, more than 50 percent but less than 100 percent of the voting stock of the following:

Decimus Corporation
Decimus Computer Leasing Corporation
Banca d'America e d'Italia

BAI Leasing Venture
Finabai-Societe Financiere S.A.
BAI Bank (Cayman) Ltd.

BA Australia Limited

Bamerical Investments (Australia) Limited
Bamerical Nominees (Australia) Proprietary Ltd.

BA (Australia) Holding Proprietary, Ltd.
BA Investors Mgt. Ltd.
BA Australia Leasing Ltd.
Bamerical Proprietary Ltd.
BA (Australia) Hong Kong Ltd.

Bank of America Cameroon
BankAmerica Representaco e Servicios Ltd.
Commercial Bank of Africa

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BRIEF OF RESPONDENT BANKAMERICA CORPORATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondent BankAmerica Corporation (Intervenor below) submits this brief in opposition to the petition for writ of certiorari filed by petitioner Securities Industry Association.

STATEMENT OF THE CASE

BankAmerica Corporation ("BankAmerica") is a bank holding company within the meaning of the Bank Holding Company Act. 12 U.S.C. § 1841. The Charles Schwab Corporation ("Schwab") provides retail brokerage and related services. (3a.)[1] In March 1982, BankAmerica

[1] The opinions below are reprinted in the appendix to the petition for writ of certiorari and are cited herein as "—a."

applied to the Board of Governors of the Federal Reserve Board ("Board") for permission to acquire Schwab. Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8), authorizes the Board to approve such acquisitions if the acquired firm's business is "closely related" to banking and the acquisition is likely to produce public benefits that outweigh any adverse consequences.

The Securities Industry Association ("SIA")—a trade association of securities brokers, dealers, and underwriters—opposed the application and requested a hearing. The Antitrust Division of the Department of Justice, the Comptroller of the Currency, and the Securities and Exchange Commission all filed comments in support of the application. (3a-4a.)

The Board ordered a formal administrative hearing, which was held before an Administrative Law Judge in September 1982. A record was developed through the submission of written testimony and documentary exhibits, followed by the cross-examination of witnesses. The United States Department of Justice participated in the hearing and again urged that the application be granted. After the hearing, the Administrative Law Judge recommended unconditional approval of the application. (22a.)

On January 7, 1983, the Board approved the application and issued a full decision and order. In its order, the Board made the following findings:

1. Schwab's retail brokerage business consists principally of acting as agent to arrange for the buying and selling of securities on customers' orders. Schwab does not engage in underwriting or dealing, does not purchase securities for its own account, and does not promote the securities of any particular issuer. (23a.)

2. Banks, through the trading desks of their trust departments, "routinely buy and sell securities as agent" for their trust accounts. Banks also

provide brokerage services to their banking customers as an accommodation. Banks frequently execute both customer and trust department orders for unlisted securities by making direct arrangements for purchase and sale. For listed securities, banks have generally used intervening brokers to execute transactions, but often in circumstances where the bank has made all basic decisions with respect to execution and left to the broker only the ministerial act of execution of the transaction. (25a-27a.)

3. In buying and selling securities for the account of customers and for trust accounts, banks have performed the same functions, utilized the same execution techniques, employed personnel with the same expertise, used the same facilities as brokers, and engaged in activities that were operationally and functionally so similar to the types of service engaged in by Schwab that banking organizations were particularly well equipped to provide them. (25a-27a.)

Based upon these findings, the Board concluded that Schwab's brokerage services were closely related to banking under the Bank Holding Company Act and were not within any proscription of the Glass-Steagall Act. The Board also found that approval of the application should result in "significant public benefits in the form of intensified competition, increased efficiency, and greater consumer convenience in the provision of retail securities brokerage services to the public" and that the benefits of the transaction warranted approval in the public interest. (32a.)

On January 11, 1983, BankAmerica acquired Schwab. On February 3, 1983, petitioner SIA sought judicial review of the Board's order in the United States Court of Appeals for the Second Circuit. On July 15, 1983, the Court of Appeals unanimously affirmed the Board's order.

The Court of Appeals held that the Board had properly concluded that Schwab's brokerage activities were

"closely related" to banking. It noted that the statute conferred substantial discretion on the Board, that the Board's findings were "clearly" supported by substantial evidence, and that the Board, in reaching its conclusion, had followed the established standards employed by other courts of appeals and by this Court in *Board of Governors v. Investment Company Institute*, 450 U.S. 46 (1981). (15a-19a.)

The Court of Appeals likewise held that the Board had properly concluded that the Glass-Steagall Act does not proscribe brokerage activities by non-bank affiliates of bank holding companies. The Court reasoned that the plain language of Section 20—the only section of the Act directly applicable—applies to underwriting activities, which involve distribution of new issues of securities, but does not embrace agency activities which involve no risk as principal or promoter. (5a-9a.) The Court of Appeals noted that this interpretation of Section 20 adheres to the Board's longstanding construction of parallel language in Section 32 of the Glass-Steagall Act, follows this Court's implicit interpretation of the same provision in *Board of Governors v. Agnew*, 329 U.S. 441 (1947), and conforms to the policies underlying the Glass-Steagall Act. (6a-9a.)

I. The Court of Appeals' Construction of the Bank Holding Company Act Is a Routine Reading of the Act That Follows the Established Precedents of This Court and Other Courts of Appeal

Section 4(c)(8) of the Bank Holding Company Act authorizes the Board to allow bank holding companies to engage in activities that it finds are "closely related" to banking. The Board and various courts of appeals have articulated standards for making this determination, including that an activity is closely related to banking if:

> **"Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service . . . ."**

National Courier Association v. Board of Governors, 516 F.2d 1229, 1237 (D.C. Cir. 1975); *NCNB Corp. v. Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Alabama Association of Insurance Agents v. Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978); *Association of Bank Travel Bureaus, Inc. v. Board of Governors*, 568 F.2d 549 (7th Cir. 1978); *Citicorp*, 68 Fed. Res. Bull. 505 (1982).[2]

This Court embraced a similar test in *Board of Governors v. Investment Company Institute*, *supra*, where the Court held that the Board properly found that investment advisory services were closely related to banking. This Court reasoned that investment advisory services are closely related to banking because they "are not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55.[3]

The well-established standard the Board and Court of Appeals applied in this case presents no issue worthy of review. That standard is consistent with the views of this Court and has been routinely applied by every court of appeals that has had occasion to consider the issue. Nor is there any conflict between the Court of Appeals' decision and the Fifth Circuit's decision in *Alabama Association of Insurance Agents v. Board of Governors*, *supra*.

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[2] As the Board and courts of appeals have noted, there is no exclusive test for determining whether an activity is closely related to banking. (15a, 24a.) *National Courier Ass'n v. Board of Governors*, 516 F.2d at 1237; *Alabama Ass'n of Insurance Agents v. Board of Governors*, 533 F.2d at 241, 244 (any rational nexus to banking suffices to make an activity closely related to banking).

[3] To the extent that SIA argues that an activity must facilitate or support authorized bank activities, Petition at 18, that contention is wholly inconsistent with this Court's decision in *Board of Governors v. Investment Company Institute*. In that case the Court never even considered whether investment advisory services for closed end mutual funds facilitate banking practices, and, as the Court of Appeals noted, "it seems quite clear that they do not." (18a.)

Alabama Insurance applied the same standard adopted by the Court of Appeals here. 533 F.2d at 241.[4]

The application of the standard to the brokerage activities in this case likewise presents no real issue.[5]

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[4] The Fifth Circuit concluded that certain types of bank insurance activities were not closely related to banking under this standard because the court had "been apprised of no general practice on the part of banks" to engage in such types of insurance activities. 533 F.2d at 241. Brokerage activities, in contrast, were found by the Board and Court of Appeals here to be generally performed by banks. (15a.)

Moreover, SIA misrepresents the Fifth Circuit's decision as requiring a "direct relationship" between an activity and banking for the activity to be considered closely related to banking, Petition at 18 (quoting 533 F.2d at 240). The discussion of a requirement of a "direct relationship" comes not from the Fifth Circuit's construction of the Bank Holding Company Act but from one of the Board regulations there at issue. That regulation authorized activities regarding insurance "directly related" to bank services, such as insurance on loan collateral. 533 F.2d at 240. The Fifth Circuit upheld the regulation because obviously activities that are directly related to banking are closely related to banking. The Court went on to find that the Board had properly found other insurance activities closely related to banking even though it believed they were only "indirect[ly]" related to banking. 533 F.2d at 241, 244.

Indeed, as noted above, *see* note 2 *supra*, there is no exclusive test for determining whether an activity is closely related to banking. The discussion in *Alabama Insurance* to which SIA refers (Petition at 18-19) dealt with other tests in addition to those set forth in *National Courier*, which would be used as an *additional* basis for finding an activity closely related to banking. That discussion is neither relevant to nor in conflict with the Court of Appeals' decision here.

[5] The Court of Appeals' application of the standard follows this Court's similar application of the standard in *Board of Governors v. Investment Company Institute*. Contrary to SIA's assertion, Petition at 13, the history of securities brokerage activity by banks is the same as that of the bank investment advisory services. Banks have engaged in both for decades. While banks have not conducted actual retail brokerage or investment advisory "businesses," *see* Petition at 13, they have traditionally offered their customers a

Banks have long performed a wide range of brokerage services. (15a, 24a.) The only thing that Schwab does that banks historically have not done is to execute its customers' trades on national exchanges. (15a-16a.) But as the Board found, banks frequently execute transactions for their customers when trading unlisted securities. Banks also often direct brokers on the desired method of execution for listed securities, leaving to the broker only technical execution, a largely ministerial act deemed to be insignificant under the closely related standard. (16a.)[6] The Court of Appeals quite properly noted that the Board's findings were supported by substantial evidence and that the Board's conclusion was well within its area of expertise and the discretion committed to it by statute.[7]

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variety of brokerage and investment advisory services. (15a, 24a-26a.)

Also contrary to SIA's assertion, Petition at 8, this was not even the first Board decision authorizing a subsidiary of a bank holding company to engage in brokerage services. *See JCT Trust Co.*, 67 Fed. Res. Bull. 635 (1981).

[6] As the Administrative Law Judge found in his Recommended Decision in this case, the only reason banks have not historically executed trades on national exchanges is that there were anti-competitive rules in earlier years that excluded banks from exchange membership and fixed prices so that there was little economic incentive for banks to compete with brokers. *See* Recommended Decision at 105-06.

[7] As the Court of Appeals pointed out,

> "The Board . . . has expertise in commercial bank regulation that the courts do not have, and it must be allowed reasonable latitude in its application of the Act to the changing activities of banks. For these reasons the Board's determination that brokerage is closely related to banking 'is entitled to the greatest deference,' *Invest. Co. Inst., supra*, 450 U.S. at 56 (footnote omitted), and may be overturned only if unreasonable or inconsistent with Congressional intent." (17a.)

Contrary to the assertion of SIA, Petition at 5, the Court of Appeals did not, however, simply defer to the Board's judgment. The Court recognized and fulfilled its "ultimate responsibility" of de-

II. The Court of Appeals' Construction of the Glass-Steagall Act Is a Routine Reading of the Act That Follows Established Precedent of This Court and Is In Accord With a Longstanding Interpretation of the Federal Reserve Board

The Court of Appeals held that Section 20 of the Glass-Steagall Act encompasses underwriting-type activities but not brokerage. Section 20 provides in relevant part that

> "[N]o member bank shall be affiliated in any manner . . . with any corporation, association, business trust, or other similar organization *engaged principally in the issue, flotation, underwriting, public sale, or distribution* at wholesale or retail . . . of stocks, bonds, debentures, notes, or other securities . . . ."

12 U.S.C. § 377 (emphasis supplied).[8]

Since 1936, language identical to that in Section 20 has been construed by the Board to apply only to underwriting-type activities and not to brokerage. The identical language appears in Section 32 of the Act, which prohibits director, officer, or employee interlocks between member banks and entities primarily engaged in "the issue, flotation, underwriting, public sale, or distribution" of securities. 12 U.S.C. § 78. As the Court of Appeals noted, this Court implicitly upheld the Board's construction of Section 32 in *Board of Governors v. Agnew*, 329 U.S. 441 (1947), and at the same time equated the list of prohibited activities in Section 20 with the "underwriting field." *Id.* at 445 & n.3. Similarly, in *Board of Governors v. Investment Company Institute*,

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termining that the Board's interpretation was reasonable and consistent with the language and policy of the Glass-Steagall Act and the Bank Holding Company Act. (4a-5a.)

[8] Bank of America NT & SA, a member bank, is BankAmerica's principal subsidiary; any other majority-owned subsidiary of BankAmerica is thus an affiliate of a member bank. 12 U.S.C. § 221a(b).

supra, this Court referred to the language of Section 20 as "prohibit[ing] national banks or state bank members of the Federal Reserve System from owning securities affiliates . . . that are 'engaged principally' in the *issuance or underwriting of securities*." 450 U.S. at 59 n.24 (emphasis added).

The Court of Appeals noted that this interpretation is consistent with the language of Section 20 itself. The terms used in Section 20 refer to underwriting-type activities and not to brokerage.[9] The Court of Appeals pointed out that elsewhere in the Act when Congress intended to deal with brokerage it did so by using words that unmistakably described brokerage activities. Thus, Section 16 of the Act authorizes banks to "purchas[e] and sell[] . . . securities . . . without recourse, solely upon the order, and for the account of, customers." 12 U.S.C. § 24 (Seventh). (6a.)

SIA claims that Section 20 should nonetheless be read as if it included the brokerage language set forth in Section 16 and that Section 16 would prohibit the brokerage activities at issue here. In fact, Section 16 would not prohibit even banks from engaging in such brokerage activities; the United States District Court for the District of Columbia has recently so held in litigation

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[9] SIA contends that the term "public sale" in Section 20 and Section 32 should be read to include brokerage as well as underwriting-type activities. Petition at 15. Not only is this argument inconsistent with longstanding interpretation of the Board implicitly approved by this Court, but it would violate the familiar principle of statutory construction that words grouped together in a list should be given a related meaning. As the Court of Appeals noted, the terms "issue," "flotation," "underwriting," and "distribution" in Sections 20 and 32 all involve the marketing of securities acquired from an issuer. (5a.) The term "public sale" has also been used as a term for underwriting-type activities, and giving it that meaning is far more natural than giving it one that encompasses brokerage, which involves secondary market trading as an agent for commission.

brought by SIA against the Comptroller of the Currency.[10] But, in any event, the Court of Appeals found it unnecessary to decide the extent of the brokerage activities permitted under Section 16. That section, the Court said, applies only to banks; Section 20 applies to bank affiliates and nothing in Section 20 prohibits affiliates from providing brokerage services. (11a-12a.)

In this respect, the Court of Appeals simply affirmed the well-settled rule that affiliates are governed by the Act's special provisions relating to them and not by limitations on the direct activities of banks. As this Court noted in *Board of Governors v. Investment Company Institute*, *supra*, the structure of the Glass-Steagall Act "reveals a Congressional intent to treat banks separately from their affiliates." 450 U.S. at 59 n.24. *See also id.* at 64:

> "In both the Glass-Steagall Act itself and in the Bank Holding Company Act, Congress indicated that a bank affiliate may engage in activities that would be impermissible for the bank itself."

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[10] In *Securities Industry Ass'n v. Comptroller of the Currency*, [Current] Fed. Banking L. Rep. (CCH) ¶ 99,771 (D.D.C. Nov. 2, 1983), SIA challenged the Comptroller's approval of the applications of two banks to acquire or establish bank subsidiaries that would engage in securities brokerage activity. Two issues were presented to the court. The first was whether a bank itself could engage in brokerage activities. With respect to that issue the District Court ruled in favor of the Comptroller and found that Section 16 did not proscribe brokerage activities by banks or bank subsidiaries. The second issue presented was whether a bank could engage in brokerage activities at offices other than authorized branches under the McFadden Act, 12 U.S.C. §§ 36, 81. On this issue, the District Court granted plaintiff's motion for summary judgment and found that a bank could not engage in brokerage activities at unauthorized branches. Of course, the McFadden Act has no application to the activities of non-bank subsidiaries of bank holding companies.

III. The Court of Appeals' Decision Presents a Narrow Question Limited to One Activity of a Nonbank Subsidiary of a Bank Holding Company

SIA seeks to portray this case as a seminal event by which regulatory agencies will launch banking institutions into a variety of activities heretofore prohibited to them. SIA refers to various litigation arising out of recent regulatory approval of different types of services offered by national banks, state banks, or savings and loan associations. It is true that SIA and other trade associations have fomented a number of proceedings seeking to prevent banks and thrift institutions from competing with their members. For example, as SIA notes, they have challenged regulatory approvals for national banks to sell commercial paper, to administer IRA trusts, and to provide investment advisory services to the public; and they have sued to prevent state chartered banks that are not members of the Federal Reserve System and federally chartered savings and loan associations from engaging in brokerage.

The instant case involves the provision of brokerage services by a non-bank affiliate of a bank holding company. It applies the Bank Holding Company Act and the Glass-Steagall Act pursuant to established standards and precedents of the Federal Reserve Board, this Court, and other courts of appeals. None of the other actions to which SIA refers concerns any of the issues involved in this case. Each raises issues that will be tested as they mature under the particular statutory provisions and regulatory schemes that are involved. It may also be, as SIA suggests, that Congress will consider one or more of these other issues. But neither the fact that such issues have been raised nor the existence of other discrete cases calls for this Court's review of the routine and narrow questions presented here.

CONCLUSION

For all of the reasons stated above, the petition for writ of certiorari should be denied.

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December 16, 1983

No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Respondents' briefs confirm, by what they do *not* dispute, that this Petition should be granted:

First, the Board does not dispute the national significance of its ruling. Anything but "routine" (BAC Br. at 11), the Board's ruling, in the words of its own counsel, is "one of first impression,"[1] permitting bank affiliates to engage in public securities brokerage for the first time in half a century.[2]

1 Post-Hearing Brief submitted on behalf of the Board to the Administrative Law Judge in these proceedings, p. 53.

2 The importance of the Board's ruling was again underscored by the recent proposal of the Securities and Exchange Commission to require banks entering the securities business to register as broker-dealers for the first time. *See* 48 Fed. Reg. 51930 (Nov. 15, 1983). Adoption of the proposed rule would doubtless mean that banks, in order to avoid direct regulation by the SEC, would increasingly attempt to conduct discount securities brokerage through holding company affiliates, as permitted by the decision below.

Second, respondents do not dispute that banks previously have not been in the business of executing securities trades, the heart of Schwab's discount brokerage business and therefore the determinative activity in this case. Respondents instead refer to bank services such as "the purchase and sale" of stock as an accommodation for their customers (Board Br. at 3) but omit that banks historically passed those orders on to brokers for execution. If banks themselves generally had executed securities trades, that activity would have satisfied the first prong of the *National Courier* test, as a service "banks generally have in fact provided." (15a.) The Board, however, concluded that this test had *not* been satisfied,[3] and it sought instead to authorize the activity only as something "functionally similar" to existing bank activities.

This decision thus reaches substantially beyond *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981). The activity there involved was not merely "functionally similar" to banking operations, it *was* a banking activity—one that "for over 50 years banks have performed." (*Id.* at 55.) Nor did this Court follow the same rationale in that case as did the Board here. (Board Br. at 6-7.) Far from authorizing the Board to sanction new "functionally similar" activities, this Court was careful to restrict the Board, upon subsequent applications, to "ensur[ing] that no bank holding company exceeds the bounds of a bank's traditional fiduciary function." (*Id.* at 57.) Yet, the Board here has approved an activity that plainly does exceed "the bounds of a bank's traditional [securities] function."[4]

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3 As the Board put it: "Schwab's activities differ somewhat from the brokerage functions usually performed by banks: Schwab executes orders for the purchase or sale of securities directly, without the assistance of an intervening broker; and executes directly on the exchange orders involving securities listed on such exchanges." (25a.)

The court below also observed "one principal difference between the securities activities of brokerage houses and of banks: brokerage houses trade listed securities, directly on the exchanges, while banks historically have used intervening brokers." (15a-16a.)

4 While the Second Circuit thought it significant that some ~~brokers~~ banks currently "direct" brokers on the method of execution they want used

Third, respondents do not dispute that the Fifth Circuit, in applying Section 4(c)(8) of the Bank Holding Company Act to activities *not* traditionally performed by banks, has required that the proposed activities further banking operations. *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978). Instead, respondents again argue that the Board here merely approved a traditional banking activity and that the Fifth Circuit rationale is therefore inapplicable. (Board Br. at 8-9.) But, as discussed, securities execution concededly is not a traditional banking activity, and accordingly would be prohibited in these circumstances by the Fifth Circuit holding. The decision below is in direct conflict. The Second Circuit, alone, has sanctioned a non-banking activity under Section 4(c)(8) *solely* upon a finding that banks are equipped to perform it, and *regardless* of whether the activity facilitates banking operations.

CONCLUSION

For the foregoing reasons and those in the Petition for Certiorari, this Court should issue a Writ of Certiorari to review the judgment and opinion of the Second Circuit Court of Appeals.

Dated: January 12, 1984

(16a), it could equally be said that some banks "direct" insurance and/or real estate brokers. Under the Second Circuit's rationale, bank affiliates could therefore also be said to be qualified to open general retail operations in those areas—directly contrary to Congress' fundamental determination to *separate* banking from commerce in general. (SIA Pet. at 11.)

Respectfully submitted,

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—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

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QUESTIONS PRESENTED

At issue is a decision of the Court of Appeals upholding a ruling of the Federal Reserve Board. That decision permits the largest bank holding company in the United States to acquire the nation's largest discount broker and thereby to engage in public securities brokerage—a business no bank affiliate has conducted since federal restrictions on bank securities activities were enacted in the wake of the national banking crisis fifty years ago. The specific questions are:

1. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that a nonbanking activity, here public securities brokerage, is "so closely related to banking . . . as to be a proper incident thereto" within the meaning of the Bank Holding Company Act, where the activity is not one traditionally performed by banks, or even one that supports a banking activity, but is only "functionally similar" to some banking operations?

2. Did the Court of Appeals err in affirming a Federal Reserve Board ruling that the flat prohibitions of the Glass-Steagall Act restricting both direct and indirect securities activities of banks need not be construed consistently, so that, depending upon an administrative view of the risks posed, a bank affiliate may be authorized to engage principally in securities activities that are barred entirely to banks?

PARTIES TO THE PROCEEDING

In addition to the petitioner* and respondents listed in the caption, the following are also respondents in this action: Paul A. Volcker as Chairman of the Board of Governors of the Federal Reserve System, Preston Martin, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmet J. Rice and Lyle E. Gramley, as Members of the Board of Governors of the Federal Reserve System, and BankAmerica Corporation as Intervenor in the proceeding below.

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* Pursuant to Rule 28.1 of this Court, petitioner states as follows: The Securities Industry Association is a national trade association representing more than 500 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States.

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BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

PRELIMINARY STATEMENT

At issue is a decision upholding an Order of the Board of Governors of the Federal Reserve System (the "Board") which approved the application of BankAmerica Corporation ("BAC"), parent of the largest bank in the nation, to acquire the Charles Schwab Corporation ("Schwab"), owner of the nation's largest discount broker. This case is one of a series of recent actions through which bank regulators, who now question the judgments made by Congress in the past, have sanctioned new bank activities by "reinterpreting" existing law.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (157A)[1] is reported at 716 F.2d 92. The order of the Board approving the BAC application to acquire Schwab (125A) is reported at 69 Fed. Res. Bull. 105 (1983).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 15, 1983. A timely Petition for a Writ of Certiorari was granted on January 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This action concerns two federal statutes designed to restrict the activities of banks and their affiliates:[2]

1. The Bank Holding Company Act, 12 U.S.C. §§ 1841, *et seq.*, broadly prohibits bank holding companies from owning any entity engaged in activities other than banking. 12 U.S.C. § 1843(a). Only limited, expressly defined exceptions are allowed. The one exception relevant here is contained in Section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), which permits a bank holding company to own an entity,

> the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking . . . as to be a proper incident thereto.

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1 Citations to material printed in the Joint Appendix appear as "____A". Citations to material contained in the Joint Appendix before the Second Circuit Court of Appeals appear as "J.A. ____".

2 Relevant statutory provisions are set out at length in the Joint Appendix at 177A-180A.

2. The Glass-Steagall Act,[3] enacted in 1933 and initially amended in 1935, following the collapse of the banking system, restricts banks from engaging directly or indirectly in the securities business. Relevant to this action are Sections 16, 20 and 21 of the Act, 12 U.S.C. § 24 (Seventh), 377 and 378, which provide, in relevant part:

Section 16 *(12 U.S.C. § 24 (Seventh))*:

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, ...

Section 20 *(12 U.S.C. § 377)*:

> After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

Section 21 *(12 U.S.C. § 378)*:

> (a) After the expiration of one year after June 16, 1933, it shall be unlawful—
>
> (1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits

3 The Glass-Steagall Act was enacted as part of the Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, and is codified in various sections of Title 12 of the United States Code.

subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: . . . .

STATEMENT OF THE CASE

A. Background

On March 8, 1982 BAC, parent holding company of the country's largest bank, applied to the Board under Section 4(c)(8) of the Bank Holding Company Act ("Section 4(c)(8)") for permission to acquire Schwab, a company engaged principally in public securities brokerage through its wholly-owned subsidiary, Charles Schwab & Co., Inc. (159A.) Public securities brokerage is a nonbanking activity the Board had never previously found to be permissible for a bank affiliate.[4]

Before BAC announced its plans, no bank or bank holding company had engaged in the securities brokerage business since the passage of the Glass-Steagall Act half a century ago.[5] Within a year after BAC's application, federal bank regulators had taken action to permit *all* of the banking entities under

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4 As Board Counsel acknowledged before the Administrative Law Judge, the BAC application to acquire Schwab was "one of first impression." Post Hearing Brief of Board Counsel at 53 (Oct. 1, 1982), reprinted in the Joint Appendix submitted to the Court of Appeals at J.A. 368.

5 N.Y. Times, Nov. 25, 1981 at D1, col. 6; Wash. Post, Nov. 25, 1981 at D7. *See* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 Va. L. Rev. 1303, 1314-15 (1983).

their jurisdiction to enter that business. Aside from the Board's actions, in rapid succession:

— The Federal Home Loan Bank Board authorized the first nationwide joint venture by federally chartered savings and loan associations in approving a thrift-sponsored securities brokerage and investment advisory firm.[6]

— The Comptroller of the Currency, repudiating half a century of his own construction to the contrary, approved public brokerage activities for all national banks.[7]

— The Federal Deposit Insurance Corporation proposed new rules that would permit not only brokerage but securities underwriting by affiliates of all the state chartered banks under its jurisdiction.[8]

Congress, which itself was considering proposals to expand the securities activities of banks, watched with frustration. The Chairman of the Senate Banking Committee publicly described regulatory changes by the banking agencies as "go[ing] to the basic structure of our financial system."[9] A Conference Committee of both Houses of Congress even took the highly

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6 *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, et al.* (May 6, 1982).

7 *Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc.* (August 26, 1982).

8 *FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-Member Banks*, 47 Fed. Reg. 38984 (Sept. 3, 1982). *See also* 48 Fed. Reg. 22155, *et seq.* (May 17, 1983).

9 *See* 40 Wash. Fin. Rep. (BNA) No. 21 at 1085 (May 23, 1983).

unusual step in its Report on proposed banking legislation of directing the Federal Home Loan Bank Board that it:

> should not approve, in the absence of clear and specific Congressional authorization, any new regulation expanding activities of [savings and loan subsidiaries]. . . .[10]

In an alarmingly short time, the legislatively mandated line between banking and the securities business had become administratively blurred, if not erased.

B. Proceedings

In response to notice published by the Board (*see* 47 Fed. Reg. 16104 (April 14, 1982)), SIA objected to BAC's application to acquire Schwab and requested an evidentiary hearing. (125A.) The Board scheduled an expedited hearing before an Administrative Law Judge,[11] and, following submission of written statements and rebuttal testimony, a six-day hearing was held for purposes only of cross-examining witnesses who had submitted prepared statements. (126A.)

The subjects of the hearing included the activities of the Applicant, BAC, and its principal subsidiary, BankAmerica N.T. & S.A., as well as the activities of Schwab. BAC is the second largest bank holding company in the United States with total consolidated assets, at the time of the hearing, in excess of $120 billion. (159A.) It is the owner of the largest bank in the United States and is by far the dominant financial institution in California. (127A.)

Schwab, founded in 1971, became a "discount" broker after fixed-rate commissions were eliminated in May 1975. Schwab is the largest discount broker in the United States (158A) and offers its customers an array of services. (159A.) The essence

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10 S. Conf. Rep. No. 97-641, 97th Cong., 2d Sess. 88 (1982).

11 Upon consent, the Department of Justice was permitted to intervene in the proceeding before the Board. (126A.)

of its business is executing securities transactions for its 300,000 customers. (17A.) This transactional business consists almost entirely of executing, for a fee, the purchase and sale of securities (including stocks, bonds and options). Three-quarters of this business is concentrated in the execution of stock transactions (18A; J.A. 174, 300), the majority of which are completed on the New York and American Stock Exchanges.[12]

Following the hearing, briefs were submitted, and the Administrative Law Judge filed a Recommended Decision favoring the acquisition. (5A.) On January 7, 1983, the Board issued its order approving for the first time affiliation between a bank holding company and a securities brokerage firm. (125A.)

The Board recognized in its order that banks had not previously engaged in the sort of retail brokerage business conducted by Schwab (129A) and did not find that Schwab's brokerage business would facilitate banking activities. The Board nevertheless ruled (*id.*) that Schwab's business was "so closely related to banking . . . as to be a proper incident thereto" within the meaning of Section 4(c)(8) because, in its view, the activity is:

> operationally and functionally very similar to the types of brokerage services that are generally provided by banks and that banking organizations are particularly well-equipped to provide such services.

The Board also concluded that BAC's proposed securities brokerage activities were permissible under Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, even though that Section of the Act prohibits banks from affiliating with organizations "engaged principally" in the "public sale" of securities. (178A.) The Board thought the latter term should be limited to

12 At the time of the hearing Schwab had two seats on the New York Stock Exchange, one seat on the Chicago Board Options Exchange, two seats on the Pacific Exchange and was represented on the floors of other exchanges. (17A.) *See* Testimony of Schwab President Lawrence J. Stupski at 67, 74 (September 8, 1982).

a technical meaning, referring only to the distribution of "new issues or large blocks" of securities. (148A.) The Board sought to support its conclusion by reference to a 1982 ruling by the Office of the Comptroller of the Currency which reversed fifty years of its own consistent construction that banks are prohibited from engaging in public securities brokerage under Section 16 of the Act, 12 U.S.C. § 24 (Seventh). (150A.)

BAC finalized its acquisition of Schwab two business days after the Board approved the application.[13] SIA petitioned the Court of Appeals for the Second Circuit, under 12 U.S.C. § 1848, to review the Board's unprecedented order.

C. Decision Below

The Court of Appeals, deferring to the Board, accepted its construction of the terms of both the Bank Holding Company Act and the Glass-Steagall Act.

The court below embraced the Board's interpretation that the Section 4(c)(8) prohibition limiting activities to those "so closely related to banking . . . as to be a proper incident thereto," actually authorizes bank affiliates to engage in *any* business that is "functionally similar" to a traditional banking activity. (171A.) The court rejected any construction of Section 4(c)(8) requiring that activities not traditionally performed by banks be undertaken by bank affiliates only in furtherance of a permissible bank activity, the construction previously given the Act by the Fifth Circuit Court of Appeals. (173A-174A.)

Finding the acquisition also to be acceptable under the Glass-Steagall Act, the court below judged it only against the Section 20 restriction on the "public sale" of securities. The court saw no necessity to interpret the interrelated sections of the Act consistently. (167A.) It concluded that Section 20, read in isolation, "reasonably" could be construed not to include securities brokerage among the activities prohibited to bank affiliates. (161A.) In its view, bank affiliates may engage principally in securities activities prohibited entirely to banks,

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13 N.Y. Times, Jan. 12, 1983 at D4, col. 5.

if the Board determines the activity does not present the "dangers" addressed by the Act. (168A.)

Less than one month after the decision below, the Board promulgated new regulations that added securities brokerage to its list of activities generally permitted to bank holding companies.[14]

SUMMARY OF ARGUMENT

This case, one "of first impression" for the Board, involves the admitted "expansion of banking into securities activities." It reflects the recent inclination of banking regulators to sidestep statutory restrictions where they no longer fit the *regulator's* view of what policy should be.

I. The Bank Holding Company Act was intended to stop banks from evading statutory restrictions by use of the bank holding company structure. Section 4(c)(8) of that Act, one of its limited exceptions, permits bank holding companies to acquire nonbank subsidiaries only when those subsidiaries are engaged in a business that is "so closely related to banking . . . as to be a proper incident thereto." Legislative history and court interpretation show that, to satisfy the "so closely related" standard when a proposed activity has not generally been performed by banks, the activity must facilitate other banking operations.

Schwab's principal business, the determinative activity here, is execution of securities trades for the public, an activity banks generally have not performed and which does not further banking operations. The Board sanctioned the activity under Section 4(c)(8) *solely* upon a finding that it was "functionally similar" to other banking activities so that banks are equipped to perform it, *regardless* of whether the activity facilitates banking operations. In so doing, the Board administratively amended the statute to include a "functionally simi-

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14 *See* 48 Fed. Reg. 37003 (Aug. 16, 1983).

lar" standard it had previously urged upon Congress, but which Congress rejected.

By embracing the Board's rationale, the decision below not only conflicts with that of another Court of Appeals, but it transforms Section 4(c)(8) into an open-ended authorization. Under it banking organizations may be permitted to engage in any number of businesses otherwise completely unrelated to banking merely because they are seen as "functionally similar" to what some banks may do.

II. The Glass-Steagall Act, reflecting Congressional reaction to the crash of 1929 and the subsequent near-total failure of the banking system, sought to separate banking from the securities business by prohibiting bank securities activities, with only very specific exceptions. The four sections of the Act, as parts of a comprehensive statutory structure, should be construed consistently. Aimed at the same group of prohibited activities, the four sections are designed to bar banks *entirely* from engaging in those activities themselves and from affiliating with any entity that is engaged *principally* in them. The only difference in these restrictions thus concerns the level, not the type, of activities permitted for bank affiliates as opposed to banks.

The "public sale" of securities, as used in Section 20 of the Glass-Steagall Act, encompasses the same activities as its functional equivalent, "purchasing and selling," used in Section 16 of the Act. Section 16 prohibits banks from engaging in public securities brokerage, permitting only accommodation services for bank customers, if undertaken "without recourse" (*i.e.*, without risk of liability to third party purchasers or sellers). Congress understood the Glass-Steagall Act limited banks to forwarding orders from their banking customers to brokers for execution. It was on that premise that (a) the Comptroller of the Currency convinced Congress in 1935 to permit banks to accommodate orders for stock and (b) the proponents of the Securities Exchange Act of 1934 convinced Congress to except banks from the otherwise broad definition of "broker" in that Act. Because Schwab's principal activity is

securities execution for the public with full liability to third party purchasers and sellers, the Glass-Steagall Act prohibits a bank's affiliation with Schwab.

III. Deference to the Board's ruling, transforming narrow statutory exceptions into broad authorizations, is particularly inappropriate, in that only legal issues are here involved. The Board has no rulemaking authority under the Glass-Steagall Act and, whatever latitude it may have under the "so closely related" provision of the Bank Holding Company Act, it does not have discretion to rewrite the statute.

ARGUMENT

This case, important alone, raises broader policy issues of enormous economic import. Based on a century of experience, Congress has built a carefully balanced statutory structure to govern the financial services industry in this country. Extreme caution is warranted before it is in any way rearranged, even by Congress, lest the entire scheme become unbalanced.[15] During several recent terms Congress has been considering whether and, if so, how the governing structure can or should be reshaped. Thus far, Congress has reaffirmed repeatedly the fundamental public policy of separating banking from commerce.

From the time Congress chartered the Bank of the United States in 1816, two basic propositions have controlled the structure of federal bank regulation. First, banks are institutions of limited, statutorily defined power; they possess no authority beyond that expressly granted by law.[16] Second, as a

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15 *See, infra*, pp. 44-46.

16 *E.g.*, *California Bank* v. *Kennedy*, 167 U.S. 362, 366 (1897); *Texas & Pacific Ry.* v. *Pottorff*, 291 U.S. 245, 253 (1934); *Investment Co. Institute* v. *Camp*, 274 F. Supp. 624, 638 (D.D.C. 1967), *rev'd sub nom.*, *Comptroller of Currency* v. *Investment Co. Institute*, 420 F.2d 83 (D.C. Cir. 1969), *rev'd sub nom.*, *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971).

matter of national banking policy, banks generally are to be isolated from other lines of commerce, particularly the securities business.[17]

Both statutes involved in this case reinforced these principles. The Congressional restrictions, brushed aside by the Board in this case, are clear from the statutory language. For the last half century, bank affiliates have avoided public securities brokerage. Such abstinence is itself one of the surest guides to the meaning of any statutory restrictions. Even if the statutory limitations were ambiguous, however, consideration of any substantial change in the established structure of the financial services industry should be addressed only as part of Congress' ongoing inquiry. It should not be preempted, as here, by *ad hoc* administrative reaction to industry pressures.

I.

THE DECISION BELOW IS CONTRARY TO THE BANK HOLDING COMPANY ACT

The Bank Holding Company Act generally sought to prohibit bank affiliates from conducting activities other than banking. The court below, however, construed a narrowly drawn exception to that prohibition as authorizing bank affiliates to enter any line of commerce that banks have the operational or functional capacity to perform. Not only does this result conflict with a decision of another Circuit Court of Appeals; it defeats the basic Congressional policy underlying the Bank Holding Company Act.

That Act closed a statutory loophole through which banks, by using holding companies, were able to engage in activities otherwise prohibited to them. As explained by the Chairman of the House Committee on Banking and Currency, the legisla-

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17 *See, e.g., Fleckner* v. *Bank of the United States*, 21 U.S. 338, 351 (1823); *Awotin* v. *Atlas Exchange Bank*, 295 U.S. 209, 214 (1935). *See also* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of The Glass-Steagall Act*, 69 Va. L. Rev. 1303 (1983).

tion was designed to "divorce from holding companies" the power "to engage in unrelated business" that had always been denied to banks. 101 Cong. Rec. 8020 (1955) (remarks of Rep. Spence).[18]

Congress allowed only a few narrow exceptions to this general restriction, permitting bank affiliates to provide certain bank support activities, such as owning the physical property occupied by a bank and operating a safe deposit business. *See, e.g.*, 12 U.S.C. § 1843(c)(1). The exception involved in this case, while less specific, was similarly understood to have a narrow focus. As enacted in 1956, it authorized bank affiliates to conduct only activities determined by the Board to be "so closely related to the business of banking . . . as to be a proper incident thereto." Pub. L. No. 511, § 4(c)(6), 70 Stat. 137 (1956). Senator Robertson, Chairman of the Senate Committee on Banking and Currency, and a sponsor of the original Act, explained that the purpose of the exception was to allow "holding companies to continue to carry on functions closely related to banking which are *essential* for their efficient operation." 102 Cong. Rec. 6755 (1956) (emphasis added).[19]

Congress thus required a close connection between any bank holding company activity and the business of banking. As William McChesney Martin, then the Board's Chairman, testified during hearings in 1969 on proposed amendments to the

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18 A member of the Senate Banking and Commerce Committee explained during debate on the controversial bill:

> [T]he purpose of the bill . . . is to make certain that a bank holding company cannot lawfully do something that a bank cannot do.
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> * * *
>
> [M]any, many years ago Congress adopted the philosophy that banks ought not to engage in outside business. . . . [W]hat we are trying to do is bring bank holding companies within the same rules and regulations that apply to ordinary banks.

102 Cong. Rec. 6933, 6936 (1956) (remarks of Sen. Capehart).

19 *See also* H.R. Rep. No. 609, 84th Cong., 1st Sess. 16–17 (1955) ("Your committee has, however, exempted certain specific businesses which it believes to be obviously incidental to the business of banking."); S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955).

Act, the "so closely related" exception required "a direct and significant connection between the proposed activities of the company acquired and the business of banking."[20]

The Board urged Congress in 1969 to eliminate the "so closely related" test and to substitute a more flexible standard of "functionally related" to banking (*id.*), but Congress refused to do so. Although both Houses of Congress included a "functionally related" test in bills passed to amend the Bank Holding Company Act, the modification was deleted in Conference Committee.[21] As re-enacted in 1970, the exception of Section 4(c)(8) required that proposed activities be "so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).[22]

Although the Board has some latitude under Section 4(c)(8) to determine what activities comport with the "so closely related" standard, the Board does not have discretion to rewrite the standard.[23] Yet, that is what has occurred. Despite the statutory language and its legislative history, the Board here

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20 *See Hearings on H.R. 6778 Before the House Committee on Banking and Currency*, 91st Cong., 1st Sess. 199 (1969).

21 *Compare* S. Rep. No. 1084, 91st Cong., 2d Sess. 25 (1970) and H.R. Rep. 387, 91st Cong., 1st Sess. 1 (1969) *with* H.R. Conf. Rep. 1747, 91st Cong., 2d Sess. 5 (1970), *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5564.

22 The only change Congress made in 1970 was to delete the words, "the business of", from the statutory phrase "so closely related to [the business of] banking." This change made it permissible for a holding company affiliate to engage in activities closely related to those of banks in general, even if the specific holding company involved was not so engaged. *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46, 73 n.51 (1981). *See also* H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5572; 116 Cong. Rec. 41956 (1970) (remarks of Rep. Widnall).

23 *See*, *United States* v. *Larionoff*, 431 U.S. 864, 873 & n.12 (1977) ("a rule out of harmony with the statute, is a mere nullity"); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 213-14 (1975) ("rulemaking power . . . is not the power to make law").

did not require that the proposed brokerage activity have a "direct and significant connection" with banking, or indeed any connection with banking at all.

Nor is this even an instance where approval was sought to engage in a new, nonbanking activity to facilitate or support other banking operations, such as bank trust departments. Rather, the activity approved here is to be aggressively marketed to the public in general as an *independent*, nonbank undertaking.

The determinative activity in this case is executing securities transactions for the public, the principal business of Schwab.[24] Both the Board (129A) and the court below (171A-172A) recognized that this business is not something that previously has been undertaken by banks.[25] The acquisition was pursued because, through it, BAC sought "to enter the market for brokerage services."[26]

The Board therefore could not authorize the Schwab acquisition on the basis that banks have generally conducted securities execution; instead, it did so based on its view that Schwab's activities are "operationally or functionally very similar" to an activity generally conducted by banks. (129A.) For that reason alone, the Board believed the activity may be considered "so closely related to banking . . . as to be a proper incident thereto."

The functional *similarity* found sufficient by the Board is a far cry from the operational *connection* required by Congress. By administrative fiat the Board in effect has substituted its

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24 From 1980 to 1982 Schwab executed an average of 2,000 to 3,000 trades per day, the vast majority of which were executed on the New York and American Stock Exchanges. Testimony of Lawrence J. Stupski, President of Schwab, at 66-74 (September 8, 1982).

25 *See* Department of the Treasury, *Public Policy Aspects of Bank Securities Activities: An Issues Paper* at 5 (Nov. 1975) ("[a]t the present time, commercial banks do not execute securities transactions directly for their customers").

26 Application to the Board of Governors of the Federal Reserve System by BankAmerica Corporation at 3 (Feb. 8, 1982).

proposed "functionally related" criterion for the statutorily required "so closely related" test, precisely the substitution Congress itself refused to make in 1970.[27]

The Board's action went substantially beyond this Court's ruling in *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981) ("*ICI* II"), incorrectly cited in support of the Board's position by the court below. (173A-174A.) Unlike the present situation, the activity authorized for a bank affiliate in that case, providing investment advice, was not merely similar to banking activities, it *was* a banking activity—one that "for over 50 years banks have performed." *Id.*, 450 U.S. at 55. Nor did this Court adopt the rationale there that the Board followed here. To the contrary, this Court instructed the Board, upon subsequent applications, to "*ensure that no bank holding company exceeds the bounds of a bank's traditional fiduciary function.*" *Id.*, 450 U.S. at 57 (emphasis added). Yet the Board here has approved an activity that plainly does exceed "the bounds of a bank's traditional [securities] function."

The decision below also conflicts with judicial authority that did reach the issue here involved. In *Alabama Association of Insurance Agents* v. *Board of Governors*, 533 F.2d 224 (5th Cir. 1976), *cert. denied*, 435 U.S. 904 (1978), the Fifth Circuit addressed a Board regulation permitting subsidiaries of bank holding companies to engage in a variety of insurance brokerage activities that banks themselves had not previously performed. The court approved only those activities having a demonstrated connection to the basic functions of banks. 533 F.2d at 240-41. Conversely, the court rejected aspects of the Board regulation that permitted a bank holding company subsidiary, *inter alia*, to act as an insurance broker on behalf of the holding company or any nonbank subsidiaries. The court did so because brokering "[s]uch insurance simply does not

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27 *See Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development Commission*, ___ U.S. ___, 103 S. Ct. 1713, 1730 (1983) (improper to give a reading to an Act that Congress considered and rejected).

contribute to the operations of those subsidiaries actually engaged in the banking business" (*id.*, 533 F.2d at 241)—even though such brokering was *functionally similar* to that done directly in support of bank activities, which was held to be permissible.[28] It was just such a functional similarity, however, that the court below found to be sufficient.

In accepting the Board's reading of the Bank Holding Company Act, the Second Circuit cited *National Courier Association* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975). The court in that case described three factors it believed could be relevant in applying the standard of Section 4(c)(8), the second of which the Board purported to apply here.[29] But,

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28 Similarly, the court refused to allow holding company affiliates to perform the functionally similar activity of selling insurance as a "matter of convenience" for the purchaser, explaining (533 F.2d at 242):

> The Board's function is not to promote generally the public interest consistent with the policies of the Bank Holding Company Act, but to determine what activities are "closely related" to banking. While we might agree that the sale of certain types of convenience insurance would help a holding company agency "round out" its offerings to the benefit of its clients, the agency and the general public, the fact remains that the handling of convenience insurance simply is not, as broadly defined in the regulation, closely related or necessarily related at all to banking.

29 The three indicia, as described by the *National Courier* court (516 F.2d at 1237), were:

> 1. Banks generally have in fact provided the proposed services.
>
> 2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> 3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

If banks generally had executed securities trades, the proposed acquisition would have satisfied the first factor, and the Board would not have reached the second. However, the Board properly found that the first criterion had *not* been satisfied, noting, in a masterpiece of understatement, that "Schwab's activities differ somewhat from the brokerage functions usually performed by banks." (129A.) As the Board found, unlike banks, "Schwab executes orders for the purchase or sale of securities directly, without the

properly applied, this factor does not permit what the holding of the court below would allow.

The factors listed by the court in *National Courier* are merely aids to construing the "so closely related" standard in a manner that is "consistent with the legislative intent." *Id.*, 516 F.2d at 1237. As discussed, the legislative history of Section 4(c)(8) shows that its requirement is *not* met merely by showing that an activity looks like, or is "functionally similar" to, an activity of banks; rather, a nonbanking activity must be in furtherance of a permissible banking function before it may be considered "so closely related to banking . . . as to be a proper incident thereto." Thus, the court there found that courier activities involving materials other than financial data, and offered to the general public rather than to banks, were not even properly an "incidental" activity for a bank affiliate, much less "closely related" to banking. *Id.*, 516 F.2d at 1240-41. The activities were proscribed even though acting as a courier of non-financial data was *functionally identical* to acting as a financial data courier.

The Second Circuit, alone, has by the decision below sanctioned a nonbanking activity under Section 4(c)(8) *solely* upon a finding that banks are equipped to perform it, and *regardless* of whether the activity facilitates banking operations.

The consequences of this decision extend substantially beyond the confines of this case. Under the Board's "functionally similar" rationale, embraced by the court below, the capacity of banks to execute "wire transfers" of funds could, for example, be argued as sufficient to allow bank affiliates to enter the public telecommunications industry.[30] Even the long

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assistance of an intervening broker; and executes directly on the exchange orders involving securities listed on such exchanges." (*Id.*)

The court below also observed "one principal difference between the securities activities of brokerage houses and of banks: brokerage houses trade listed securities, directly on the exchanges, while banks historically have used intervening brokers." (171A-172A.)

30 Indeed, the American Bankers Association, responding recently to a Board proposal to expand its pre-approved list of nonbanking activities,

history of bank incentive programs, providing customers with toasters, calculators and other consumer goods, could be claimed as enough to justify entry into the "functionally similar" activity of retail consumer sales.[31]

Absent action by this Court, the statutory language of the Bank Holding Company Act will remain turned inside out. A narrowly drawn exception to a broad Congressional prohibition will be transformed administratively into an unintended and open-ended authorization.[32] For this reason alone, the decision below should be reversed.

II.

THE DECISION BELOW IS CONTRARY TO THE GLASS-STEAGALL ACT

The Glass-Steagall Act was passed in the wake of the near-total collapse of the American financial system—a collapse blamed in large part on abuses by national banks in the securities area. By the end of the 1920s, national banks had expanded their activities to the point of dominating investment banking, and "the institutional separation" of commercial and investment banking had become largely "a thing of the

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requested the Board to permit a variety of telecommunications services under Section 4(c)(8). *See* 41 Wash. Fin. Rep. (BNA) No. 7 at 225 (Aug. 15, 1983).

31 The court below also thought it significant that a few large banks currently may "direct" brokers on the method of execution they want used. (172A.) But, it could equally be said that some banks "direct" insurance and real estate brokers in procedures to be followed. Under the rationale of the Court of Appeals, bank affiliates could therefore also be said to be qualified to open retail operations in those areas—directly contrary to Congress' fundamental determination to *separate* banking from commerce in general.

32 It would be particularly anomalous if public securities brokerage, which is entirely prohibited for banks under the Glass-Steagall Act (*see, infra*, pp. 20-34), could nevertheless be deemed a "proper incident" to "banking" under Section 4(c)(8) when it is the principal business of a bank holding company affiliate.

past."[33] By February 1933 the question in the public mind was not whether, but when, the system would collapse totally,[34] and the five-day national banking holiday declared by the President on March 5, 1933 signalled that collapse.

Congress' legislative response was the Glass-Steagall Act. Passed in 1933 and initially amended in 1935, the Act remains a firm prohibition on the securities activities of national banks. In stark contrast to other legislation passed during that era,[35] the terms of the Glass-Steagall Act are not regulatory but prohibitory. Congress did not seek to supervise bank securities activities; it sought to prohibit them, with only narrowly circumscribed exceptions.

The Glass-Steagall Act was "a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse," not only by national banks, but by all depository institutions. *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629 (1971) ("*ICI* I"). Through the Glass-Steagall Act, Congress meant to separate depository institutions from the securities business "as completely as possible." *ICI* II, 450 U.S. at 70.

A. The Glass-Steagall Act Limits Bank Securities Activities Solely To Riskless Accommodation Services Provided To Bank Customers

One of Congress' specific concerns in adopting the Glass-Steagall Act was the combination of securities brokerage and commercial banking. Representative Kopplemann, a member

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33 Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 Banking L.J. 483, 496 (1971).

34 During the winter of 1932-33, thirty states declared complete or partial bank holidays, and almost 2,300 bank failures occurred across the country. Willis and Chapman, *The Banking Situation* at 7, 10 (1934); Klebaner, *Commercial Banking in the United States: A History* at 131-35 (1974).

35 *E.g.*, Securities Act of 1933, 15 U.S.C. §§ 77a, *et seq.*; Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, *et seq.*

of the House Banking and Currency Committee, urged during the debates on the Act that "[t]he unholy alliance between the brokerage office and the banks must be broken." 77 Cong. Rec. 3907 (1933). He explained that a bank director should be precluded from acting as a fiduciary for depositors at the same time as "he wants to add to the commissions and underwriting profits of his own company." *Id.* Again, describing before the House the section of an initial bill that ultimately became Section 21 of the Glass-Steagall Act, Representative Luce, a co-manager of the bill along with Representative Steagall, explained that the Section "cuts out brokers from deposit banking." 77 Cong. Rec. 3916 (1933). In short, as this Court has observed, Congress intended the Glass-Steagall Act to separate depository institutions from "securities firms such as underwriters or brokerage houses." *ICI* II, 450 U.S. at 63.

Congress addressed the brokerage question most specifically in Section 16 of the Act. There, it revoked the authority to deal in investment securities it had recognized for the first time only several years earlier[36] and, as amended in 1935, provided that henceforth that business would be "limited" strictly to "purchasing and selling securities and stock without recourse, solely upon the order, and for the account of, customers and in no case for its own account." *See* 49 Stat. 684 (1935). Through Section 16, as will appear, Congress meant to restrict banks solely to accommodating their banking customers by forwarding the customers' securities orders to brokers for execution.

1. Banks are limited to accommodating orders from their banking customers.

Banks are limited by the statutory language solely to accommodating orders of their "customers". That Congress meant to limit this service solely to *banking* customers appears from

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36 In 1927, in response to competitive pressure from state banks and trust companies, Congress for the first time granted national banks authority to deal in "investment securities" (high quality debt instruments, but not corporate stock). McFadden Act, c.191, § 2, 44 Stat. 1226 (1927).

the statutory language itself, particularly when compared with the language of statutes that deal with public securities brokerage. In the Glass-Steagall Act, avoiding broader terms such as "third parties" or "others", Congress limited the activity to "customers"; whereas, in contemporaneously enacted securities statutes Congress used the unrestricted phrase, "for the account of others."[37]

Even assuming there were ambiguity in the limitation intended by the Glass-Steagall Act, its legislative history and decades of consistent administrative construction leave no doubt as to its scope. The relevant language of the statute derives from Congressional action in 1935. The applicable history begins in January 1934 with concern expressed by the Comptroller of the Currency, who had authority over all national banks, that Congress in 1933 had gone too far in Section 16, by limiting the accommodation services allowed to "investment securities."[38]

In his first Annual Report to Congress (required by 12 U.S.C. § 14) after the Act's passage, the Comptroller noted that "[i]t would appear from the language [of Section 16] that a national bank is prohibited from performing the service of purchasing or selling corporate stocks for the account of one of its customers." However, the Comptroller stated his belief "it was not the intention of Congress to penalize the public located in communities removed from the money centers in disposing of or purchasing securities in the form of corporate

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37 *See* Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(4), enacted by the same Congress the following year. That statute of course related to the public brokerage business. In it Congress defined a "broker" broadly as a person "engaged in the business of effecting transactions in securities for the account of others. . . ." Ch. 404, § 3(a)(4), 48 Stat. 881, 883 (1934). *See* Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 Va. L. Rev. 1303, 1325-30 (1983).

38 As initially enacted, Section 16 provided: "The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and upon the account, of customers. . . ." Glass-Steagall Act, c.89, § 16, 48 Stat. 184.

stocks for investment purposes." *Annual Report of the Comptroller of the Currency* at 11 (Jan. 3, 1934).[39] He recommended that the section be amended also to include stock, emphasizing that "this does not entail the investment by the bank of its own funds *and the bank merely acts in an accommodation capacity.*" (*Id.*, emphasis supplied.)

The House and the Senate banking committees both accepted the Comptroller's recommendation in bills reported out to the full Congress,[40] but the proposed legislation foundered on the last day of the legislative session.[41]

In a letter sent to all national bank examiners a month later, the Comptroller stated that "my contact with Congress convinces me that my statement with reference to the intention of that distinguished body was correct and that only the rush of closing business prevented the passage of the bill." He then announced: "I have this day held that national banks have the right to purchase and sell stocks solely upon the order and for the account of customers," but again emphasized that "*this*

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39 The Committee Reports accompanying the Glass-Steagall Act had said that "[n]ational banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore. . . ." S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933). *See also* H.R. Rep. No. 150, 73d Cong., 1st Sess. 16 (1933). Banks had previously accommodated orders for securities and stock from their customers as an incident to their banking services. *See, e.g., Block* v. *Pennsylvania Exchange Bank*, 253 N.Y. 227, 232, 170 N.E. 900, 901 (1930) (referring to the general practice of "the purchase of securities for the benefit of customers whose loan deposit accounts are sufficient, as a result of loans or otherwise. . . .").

40 For example, Section 4(a) of S. 3748, 73d Cong., 2d Sess. 3-4 (1934) would have amended Section 16 to read: "The business of dealing in investment securities and stock by the association shall be limited to. . . ." *See* S. Rep. No. 1260, 73d Cong., 2d Sess. 2-3 (1934) ("This amendment was recommended by the Comptroller of the Currency in his Annual Report dated Jan. 3, 1934.").

41 *See Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 661 (1935).

does not mean that national banks may do a brokerage business."[42] (*Id.*, emphasis supplied.)

The Federal Reserve Board, in turn, similarly concluded in September 1934 that state-member banks under its jurisdiction could accommodate their customers by forwarding orders to buy and sell stock, but quoted the Comptroller's statement that "[t]his does not mean that national banks may do a brokerage business." 20 Fed. Res. Bull. 609 (1934).[43]

The Comptroller continued to press his amendment after Congress convened in 1935. Echoing what he had said in his January 1934 Annual Report and his July 1934 ruling, the Comptroller told the House Banking Committee his amendment would make clear that:

> section 16 of the Banking Act of 1933 was not intended to prohibit national banks or member banks from buying or selling stocks *solely for the account of their customers and as an accommodation thereto* and not for their own account.[44]

It was no accident that throughout 1934-35 the Comptroller repeatedly pointed out the "accommodation" restriction on bank activities imposed by Section 16. He was urging Congress to amend Section 16, which in part sought to prohibit speculation in securities, in order to permit banks expressly to transmit orders for stock, often a highly speculative security. Even in the

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42 This ruling was reprinted in *American Banker*, July 10, 1934 at 3. The Comptroller's ruling became necessary because the restrictions in Section 16 on dealing in securities had become effective in June 1934. *See* 48 Stat. 185 (1933).

43 Under 12 U.S.C. § 335 state member banks were, and are, subject to the same limitations upon transactions in stock as national banks.

44 *Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935) (emphasis added). The Comptroller made much the same statement before the Senate Banking Committee. *Hearings on H.R. 7617 before the Senate Committee on Banking and Currency*, 74th Cong., 1st Sess. 154-55 (1935).

McFadden Act of 1927, the *only* instance in which Congress expressly authorized banks to deal in securities, Congress had limited the authority to the substantially less risky "investment securities." *See* 44 Stat. 1226 (1927). Obviously aware that Congress would be sensitive to his proposal, the Comptroller was careful to emphasize the limited role permitted for banks under the Glass-Steagall Act.

Based upon the Comptroller's testimony that banks were already prohibited from a general brokerage business, uncontradicted by any other legislative history, Congress amended the Glass-Steagall Act in 1935 to include "securities and stock" within Section 16 rather than only "investment securities." Banking Act of 1935, c.614, § 303, 49 Stat. 707.

The Congressional understanding of the limitation contained in Section 16 is also confirmed by the legislative history of the Securities Exchange Act of 1934, which was being debated at the same time Congress was considering the Comptroller's original proposal to amend the Glass-Steagall Act.[45] An important witness during the February 1934 hearings on that securities legislation was Thomas G. Corcoran, one of its principal draftsmen. Mr. Corcoran voiced concern during his testimony that banks, which had been removed from the public securities brokerage business by the Glass-Steagall Act, might inadvertently be covered by proposed regulations intended only for securities brokers. Addressing a provision imposing borrowing limitations on "any person who transacts a business in securities," including those who forward orders to brokers for execution, he explained:

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45 It was generally recognized that the Glass-Steagall Act and the Securities Exchange Act were parts of a comprehensive legislative scheme. As Marriner S. Eccles, Governor of the Federal Reserve Board, testified: "[a]nother purpose of recent banking legislation, and particularly of the banking bill of 1933 and of the portions of the Securities Exchange Act that deal with the powers of the Federal Reserve Board, has been to prevent the recurrence of speculative excesses which preceded the recent break-down of our banking machinery and were partly responsible for this collapse." *Hearings on H.R. 5357 before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 179-80 (1935).

> The bill needs to be clarified, so that a bank which just acts for you in passing on an order to a broker, for you, does not come within that sort of a provision.
>
> MR. KENNEY. Why should that limitation be taken out?
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> MR. CORCORAN. Because there are plenty of other limitations on the banks. A bank cannot normally go in the business, like a broker, of dealing in securities. For your convenience, for a service—
>
> MR. KENNEY. But they do.
>
> MR. CORCORAN. They are not allowed to do those things any longer, under the Glass-Steagall bill. They cannot go into a business of dealing in securities, but they can still make a service charge for passing on for you, as a customer—[46]

Again, testifying before the Senate Banking Committee, Mr. Corcoran explained that the provision should exclude banks because:

> Of course under the Glass-Steagall bill a bank can no longer peddle securities at retail. It can do two things: it can buy securities for its own account, for its own investment; and it can act as agent to transmit to a broker an order to purchase or sell securities, given to it by one of the bank's customers.
>
> Certainly we had no conception when we drafted the language of this bill that it would be said that if a bank bought securities for its bond account, or merely transmitted, for a service charge, an order from a customer to a broker (because very often customers of banks do not know whom to go to for brokerage service), that operations of that kind on the part of a bank constituted transacting a business in securities.
>
> And I might say that if there is any difficulty with that language, or any conception that it does cover a bank,

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46 *Hearings on H.R. 7852 and 8720 before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 86 (1934).

> acting as banks may act under the Glass-Steagall Act, then the language should be changed so that banks so acting are not within the scope of the language. . . .[47]

The Senate Banking Committee before whom Corcoran testified was the same committee that, in the first session of the same Congress, had considered the bill that became the Glass-Steagall Act, and the same committee that in 1934 would accept the Comptroller's proposed amendment to that Act. Plainly, if any of its members had disagreed with Mr. Corcoran's summary of the Glass-Steagall restrictions, the hearings would reflect it. They do not. Instead, accepting the Corcoran recommendation, Congress expressly excepted banks from the definition of a "broker" in the Securities Exchange Act, 15 U.S.C. § 78c(a)(4), obviously understanding that banks, as Mr. Corcoran had explained, were not permitted to engage in the securities brokerage business.[48]

In sum, Congress *twice* enacted legislation freeing banks from limitations that otherwise would have applied, after hearing explanations by the proponents of the legislation that banks were severely limited by the Glass-Steagall Act to accommodating their banking customers by forwarding securities orders to brokers for execution. And, as this Court put it in *Zuber* v. *Allen*, 396 U.S. 168, 192 (1969):

> [W]hen the administrators participated in drafting [enabling legislation] and directly made known their views to Congress in committee hearings . . . absent any indica-

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47 *Hearings on S. Res. 84, 56 and 97 before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 6470 (1933).

48 Congress' solution to Corcoran's concern about the specific borrowing limitation addressed was, first, to make it applicable only to members of national securities exchanges and to "brokers" and "dealers" who transact business with them; and, second, to exclude banks from the Act's definition of "broker" and "dealer". *Compare* S. 2693, 73d Cong., 2d Sess. §§ 3.4, 3.5 and 7 (Feb. 1934) with S. 3420, 73d Cong., 2d Sess. §§ 3(a)(4), 3(a)(5) and 7(a) (April 1934).

> tion that Congress differed with the responsible department, a court should resolve any ambiguity in favor of the administrative construction, if such construction enhances the general purposes and policies underlying the legislation.

Here: (1) the Comptroller proposed the statutory amendments to the Glass-Steagall Act; (2) the Comptroller made known his views concerning the accommodation limitation in statements before Congressional committees; (3) Congress subsequently enacted the proposed amendments with no indication of a contrary intent; and (4) the Comptroller's construction furthered a statutory purpose of separating banks from transactions in speculative securities. The same applies to the Corcoran testimony concerning the Securities Exchange Act.[49]

The Comptroller's office reaffirmed the limited scope of the brokerage exception in interpretations issued immediately after the 1935 amendments to the Glass-Steagall Act had been passed, and repeatedly thereafter for almost fifty years. The Comptroller's 1936 Digest of Opinions, for example, stated that Section 16:

> is to be construed as limiting the purchase and sale transactions mentioned *to actual customers of the bank, which customer relationship exists independently and apart from the particular transaction in which the bank buys or sells* upon the order and for the account of such "customer," in distinction to the relationship arising solely by virtue of the particular transaction. . . .[50]

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49 Corcoran was one of a small group assembled to draft the bill after Senator Fletcher, Chairman of the Senate Banking Committee, requested Commissioner J.M. Landis of the Federal Trade Commission to prepare legislation to regulate the stock exchanges. *See Hearings on H.R. 7852 and 8720 before the House Committee on Interstate Banking and Commerce*, 73d Cong., 2d Sess. 82-83 (1934).

50 1 *Bulletin of the Comptroller of the Currency* No. 2 at 2 (Oct. 26, 1936) (emphasis added).

The Comptroller's Digests published over the ensuing *three decades* were equally firm.[51] Although the Comptroller's Digests were discontinued in the early 1960s, the Comptroller's view of the limited accommodation brokerage exception stood until 1982.[52] In August of that year, six months *after* BAC filed its application to acquire Schwab, the Comptroller repudiated his earlier interpretations of Section 16 in approving an application by Security Pacific National Bank to establish an operating subsidiary to engage in public securities brokerage.[53]

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51 Comptroller's Digests were published in 1948, 1957 and 1960. The Comptroller's 1957 Digest, for example, stated:

> Services in this field must be limited to actual customers of the bank—*that is, the customer relationship must exist independently of the particular securities transaction.*

Digest of Opinions of the Comptroller of the Currency, § 220A (1957) (emphasis added). Again, in 1960 the Comptroller held:

> Although R.S. 5136 [in pertinent part, § 16 of the Glass-Steagall Act] prohibits national banks from dealing in securities (except so-called "exempt" securities) for their own account, it permits them to purchase and sell securities (including stock) for the account of their customers. *However, the activities of the bank in this capacity are confined to those of an accommodation agent for the convenience of customers.*

Digest of Opinions of the Comptroller of the Currency, § 220, 220A (1960) (emphasis added).

52 In 1974, addressing the operation of "automatic investment service" plans by national banks, the Comptroller said he regarded his earlier opinions perhaps to have been over-cautious to the extent they prohibited a bank from charging a fee for this service. He retained all other aspects of his earlier opinion, however, including the requirement that customers for whom brokerage services were performed must have a *bona fide* banking relationship with the bank. *See* letter to G. Duane Vieth (June 10, 1974), *reprinted in* [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

53 Since that decision Security Pacific has incorporated a wholly-owned brokerage subsidiary and has bought its own seat on the New York Stock Exchange. *See* N.Y. Times, Aug. 3, 1983 at D6, col. 1; 39 Wash. Fin. Rep. (BNA) No. 9 at 378 (Aug. 30, 1982). The Comptroller's decision is now the subject of a court challenge. *See, infra*, n. 54.

The court below was inclined to give "significant weight" to the Comptroller's reversal. (167A.) But, coming as it did after five decades of directly contrary interpretation, through the administrations of no fewer than seven different Comptrollers, the recent ruling actually is entitled to virtually no weight. *Watt* v. *Alaska*, 451 U.S. 259, 273 (1981). The prior, long-standing administrative construction by "[t]hose who knew best what Congress intended" is entitled to substantial weight over recently articulated administrative revisions. *Morton* v. *Ruiz*, 415 U.S. 199, 237 (1974); *Espinoza* v. *Farah Manufacturing Co.*, 414 U.S. 86, 94 (1973).[54]

The Comptroller's statutory construction of several decades was also consistent with the general limitation upon the "incidental" powers of banks.[55] A line is to be drawn between (a) services offered to bank customers as an incident to their banking relationship and (b) services offered to the public at large, which are plainly *ultra vires* for banks. In *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972), for example, the Comptroller argued that banks could conduct a public travel agency because they had obtained tickets for their regular customers in the past. But, as the First Circuit held in rejecting the argument, an "incidental good will service of this kind cannot reasonably be equated with the operation of a modern travel agency for profit." 472 F.2d at 433.

It would be anomalous indeed if the law condoned an administrative agency's first convincing Congress to amend a

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54 Judge Flannery of the District Court for the District of Columbia, relying upon his own decision in *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *vacated sub nom. New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978), has affirmed the Comptroller's new construction of the Glass-Steagall Act, in a decision now on appeal. *Securities Industry Ass'n* v. *Conover*, No. 82-2865 (D.D.C., Dec. 16, 1983), *appeal docketed*, No. 84-5085 (D.C. Cir. Feb. 9, 1984).

55 Section 16 in fact was an amendment to the section of the National Bank Act of 1864, 13 Stat. 101, that confers "incidental" powers upon national banks. 12 U.S.C. § 24 (Seventh).

prohibitory statute to include expanded authority on the ground that the affected institutions were already subject to other strict limitations on how the requested authority could be used, and then, after that expanded authority is obtained, doing an administrative about-face to announce—with no further Congressional action—that the other limitations never existed at all.

2. Banks are limited to forwarding orders on a "without recourse" basis.

Congress' understanding that banks were prohibited from engaging directly in the brokerage business is also reflected in its requirement that bank securities services be "without recourse." Although in its narrowest sense that phrase means without endorsement or guaranty, this Court has specifically admonished that it is *not* to be so limited; rather, the words were "used in a broad and nontechnical sense." *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935). As was held in *Awotin*:

> The phrase is broader than a mere limitation upon the power to contract, although embracing that limitation. It is a prohibition of liability, whatever its form, by way of "recourse" growing out of the transaction of the business..

Id., 295 U.S. at 214.

The *Awotin* decision addressed "without recourse" as used in a section of the McFadden Act that previously had permitted principal activities in securities.[56] Congress left the "without recourse" limitation in place when it amended that section in 1933 through the Glass-Steagall Act to restrict banks solely to accommodation services and, again in 1935, when Congress amended the section to include stocks.

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56 *Awotin* concerned a claim by a purchaser of bonds from the defendant bank which, as a principal, had agreed to repurchase the bonds at the price the purchaser had paid for them plus accrued interest. This Court found the bank's assumption of liability prohibited by the "without recourse" limitation.

Congress almost certainly was aware of this Court's decision in *Awotin* when it reenacted the "without recourse" restriction in 1935.[57] Clearly, Congress then used "without recourse" in its nontechnical sense. At that time Congress was extending the provision to transactions involving "stock," and the phrase in a technical sense would be meaningless in that context because stock necessarily is sold without endorsement or guaranty.[58]

This Court has instructed that the "without recourse" provision should be construed so as to be "consonant with all the different forms of business to which the proviso relates." *Awotin*, 295 U.S. at 211. Technically, "without recourse" implies avoidance of an endorser's or guarantor's risk of liability to third parties. The question, therefore, is what analogous risk of liability to third parties exists in brokerage transactions.

As Congress obviously recognized, there is indeed such a risk. Brokers who execute trades for their customers risk liability to third-party purchasers or sellers for the entire amount of those trades. If their customers fail to deliver funds or securities on the settlement dates, the brokers must make good on the trades and then look to their customers for recovery. This risk, which always exists when the market moves

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57 This Court decided *Awotin* on April 29, 1935, and Congress enacted the 1935 amendment to Section 16 of the Glass-Steagall Act just four months later, on August 23, 1935. Presumed Congressional awareness of judicial constructions is a well-established principle. *E.g.*, *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978), and authorities cited therein. The doctrine is particularly apt here, where the interpretation involved is this Court's decision construing the *same* language, in the *same* statutory provision that Congress was considering amending at the *same* time the decision was rendered.

58 *See Awotin*, 295 U.S. at 212, where this Court rejected the technical reading of the phrase in that it would not have applied to instruments such as bonds or debentures because they are "usually negotiated without endorsement." (*Id.*) The only answer to the "without recourse" restriction in the Board's ruling (150A-151A n.50) was that the phrase is inapplicable because it means endorsement or guaranty—completely ignoring this Court's flat rejection of that interpretation.

against customers' positions, is magnified enormously in a market turn such as the panic of 1929.[59]

The court below appeared to recognize that "without recourse" was intended to prevent the risk of liability to third parties, and acknowledged the exposure of brokers to claims by third-party purchasers or sellers. The court nevertheless held the statutory requirement to be satisfied because, here, the broker "retains full power to bring actions for breach of contract against customers who fail to pay for or deliver securities." (169A n.4.) This circular reasoning, however, completely misses the point. The issue is not whether a bank may have recourse against its own customers but whether third parties have recourse against a bank at all.[60]

"Without recourse," in a brokerage context, means that risk of liability to third-party purchasers or sellers must be avoided entirely. This can be accomplished by banks' passing orders from their customers along to a broker for execution pursuant to an arrangement under which the broker looks directly to the customer for performance. (*See* J.A. 249-57.) "Liability [to the bank] . . . by way of 'recourse' growing out of the transaction of the business" (*Awotin*, 295 U.S. at 214; citations omitted) is thereby avoided.

This interpretation is consistent with the historical service offered by banks as an accommodation, forwarding their

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59 The potential harm to brokers from customer fails was again amply demonstrated during the early 1970s when excessive fails contributed to the demise of a number of major brokerage firms. *See* Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Brokers and Dealers*, H. Doc. 92-231, 92d Cong., 1st Sess. 1, 19, 96 (1971). While back-office capabilities and practices that then existed have been enhanced, the risk always associated with excessive fails continues to exist.

60 If a right over against customers had been Congress' object, the "without recourse" requirement would have been superfluous, in that an agent always has such a right against its principal. It is fundamental that all terms used by Congress should be given effect. *See, e.g., United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955) ("[i]t is our duty 'to give effect, if possible, to every clause and word of a statute,'. . . rather than to emasculate an entire section, as the Government's interpretation requires") (citation omitted); *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).

customers' securities orders to brokers for execution. It also reflects the policy underlying the Glass-Steagall Act to bar banks from incurring any risk in connection with speculative securities. Through its restrictions, Congress prohibited banks from underwriting stock and from purchasing it for their own accounts, thereby eliminating any risk to banks as principals. And, furthering the same objective, Congress eliminated any risk to banks in stock brokerage transactions, as agents, by retaining the requirement in Section 16 that all transactions be "without recourse."

In sum, the statutory language, legislative history and precedent of this Court all confirm that banks are strictly limited solely to accommodating their bank customers by forwarding their orders for securities and stock to brokers for execution.

B. The Sections Of The Glass-Steagall Act Should Be Read Consistently To Prohibit Public Securities Brokerage By Bank Affiliates

What is generally known as the "Glass-Steagall Act" comprised four sections (16, 20, 21 and 32) of the Banking Act of 1933, codified at 12 U.S.C. §§ 24, 78, 377 and 378. Together, as amended in 1935, these sections: (1) entirely prohibit banks from engaging *directly* in various securities activities and (2) substantially restrict the ability of banks to engage *indirectly* in these prohibited activities through affiliation or management interlocks with other entities.

Section 16 of the Glass-Steagall Act (177A-178A) provides that member banks of the Federal Reserve System "shall not underwrite any issue of securities or stock" nor purchase any "securities or stock" for its own account unless they are "investment securities" as defined in the statute.[61] 12 U.S.C. § 24 (Seventh). As discussed above, Section 16 also expressly prohibits member banks from "dealing in securities and

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61 Section 16 itself applies directly to national banks, and certain of its restrictions on securities activities are made applicable to state member banks by 12 U.S.C. § 335.

stocks" except where such dealing is "without recourse, solely upon the order, and for the account of, customers." *Id.* Section 21 of the Act (178A-179A), in turn, makes it illegal for all depository institutions to engage in the "business of issuing, underwriting, selling or distributing" securities, except to the extent permitted by Section 16. 12 U.S.C. § 378. These two provisions constitute a bar against any direct bank involvement in the prohibited activities.

Sections 20 and 32 of the Act extend that bar to indirect bank activities. Section 20 (178A) prohibits banks from affiliating with any organization that is "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities. . . ." 12 U.S.C. § 377. Section 32 of the Act (179A) prohibits interlocking management relationships between member banks and organizations that are "primarily engaged" in the prohibited activities. 12 U.S.C. § 78.

In short, Congress provided a comprehensive structure governing banks' direct and indirect participation in the prohibited activities. Banks themselves are barred completely from engaging in those activities, and entities related to banks through affiliation or management interlocks are barred from engaging "principally" or "primarily" in them. *Cf.*, *ICI* I, 401 U.S. at 629.

In terms of brokerage, as discussed, the most specific restriction is that of Section 16, which limits a bank activity to "purchasing and selling such securities and stock, without recourse, solely upon the order, and for the account of, customers." (177A.) Section 21, however, also prohibits the "selling" of securities. (178A.) And, although Section 20 does not use the phrase "purchasing and selling" verbatim, it uses the functional equivalent, prohibiting the "public sale" of securities. (*Id.*)

The Board itself elsewhere has urged this Court that "words in the [Glass-Steagall] Act gather meaning from other words in the statute as well as from the underlying legislative pur-

pose."[62] Specifically the Board's counsel, although contending that the proposed acquisition of Schwab is not prohibited, argued before the Administrative Law Judge in these proceedings that the phrases "purchasing and selling" and "public sale," as functional equivalents and parts of a comprehensive statutory scheme, should be construed consistently as encompassing brokerage.[63]

This Court as well has pointed out the congruity of the statutory terms used. In *ICI* I, 401 U.S. at 626 n.12, the Court observed:

> The limitations that the banking laws place on the activities of national banks are at least as great as the limitations placed on the activities of their affiliates. For example, § 32 refers to the "public sale" of stocks or securities while § 21 proscribes the "selling" of stocks and securities.[64]

This approach is consistent with standard rules of statutory construction, which provide that all sections of a statute should be construed consistently.[65]

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62 Brief for the Respondents at 23 n.35, *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766, *cert. granted*, Oct. 3, 1983.

63 Post-Hearing Brief of Board Counsel at 22-23 (Oct. 1, 1982); J.A. 354-355.

64 Section 32 as initially enacted itself referred to firms primarily engaged in "purchasing, selling or negotiating securities." 48 Stat. 194. This terminology was amended in 1935 to refer to the "issue, flotation, underwriting, public sale, or distribution" of securities, through what were described as "technical amendments." *See* H.R. Rep. 742, 74th Cong., 1st Sess. 2 (1935) ("amendments make no fundamental changes in the existing banking laws"). Plainly, Congress regarded "public sale" and "selling" as equivalent terms.

65 *E.g.*, *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975); *NLRB* v. *Lion Oil Co.*, 352 U.S. 282, 288 (1957) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."); *Marine Carriers Corp.* v. *Fowler*, 429 F.2d 702, 706-07 (2d Cir. 1970), *cert. denied*, 400 U.S. 1020 (1971), and authorities cited therein.

Legislative history of the Act also confirms that Congress intended a comprehensive restraint applying both to banks and their affiliates. Opposition to the Act arose in part because of its broad sweep. As argued during debate in the Senate, the sections dealing with the securities activities of banks and bank affiliates are "*interrelated with a single purpose* . . . to sweep away the whole machinery of the investment business of the member banks." 75 Cong. Rec. 1412 (January 9, 1933) (remarks of Sen. Metcalf).[66]

Nothing in the legislative history suggests that the phrase "public sale" in Section 20 was addressed to any narrower range of activities than its functional equivalent "purchasing and selling" used in Section 16. Since the Act was passed, moreover, Congress repeatedly has confirmed its understanding that the activities prohibited similarly reach *both* banks and their affiliates.[67]

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66 These comments were addressed to, *inter alia*, Sections 14 and 18 of S.4412, 72d Cong., 1st Sess. 34, 43 (1932), which became Sections 16 and 20 of the Glass-Steagall Act. As Senator Metcalf further explained (*id.*):

> Section [16] eliminates the investment business as an integral part of a bank, and Section [20] does away with the investment business as a separately incorporated bond department or security affiliate. . . . The Congress should understand thoroughly the sweeping effect which this bill will have upon this phase of banking, and the drastic measures taken to carry out the motives of those responsible for these policies.

67 For example, when considering amendments to the Bank Holding Company Act in 1970 Senator Sparkman, Senate Chairman of the Conference Committee, stressed that bank affiliates could not avoid the Glass-Steagall Act prohibitions on the activities of banks:

> Mr. WILLIAMS of New Jersey. I have one question I should like to ask the chairman of the committee. . . . I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.
>
> Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands, *the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business.*

116 Cong. Rec. 42430 (1970) (emphasis added), *quoted in ICI* II, 450 U.S. at 75 n.55. *See also* S. Conf. Rep. No. 641, 97th Cong., 2d Sess. 92 (1982),

The court below nevertheless reasoned that "the same prohibitions do not apply" to banks and their affiliates under Sections 16 and 20 (168A), citing to this Court's decision in *ICI* II. But, as this Court made clear in *ICI* II, 450 U.S. at 61 n.26 and 64, the difference between the prohibitions of Sections 16 and 20 relates solely to the permitted level of activity allowed to banks as opposed to bank affiliates, not to the substance of those activities. Section 16 bars banks from "engaging" in the prohibited activities to any extent, while Section 20 bars affiliates from engaging "principally" in such activities. The difference between the two sections noted in *ICI* II had nothing to do with the *type* of prohibited activities, but merely with the *degree* of involvement permitted.

Considering Section 20 in isolation, the court below further limited its scope by citing the maxim that words grouped in a list should be construed similarly. The court concluded under this analysis that "public sale" should be restricted by the other terms used in Section 20 ("issue," "flotation," "underwriting," and "distribution"), to include only activities "in which the dealer trades as principal for his own profit." (161A.) Such a conclusion could be justified, however, only if all of the terms being compared with "public sale" were limited solely to principal activities.[68] But, the term "underwriting" as used in Section 20 certainly includes "best efforts" underwriting, which is an agency, not a principal, activity.[69] There is no more

explaining that authority granted bank subsidiaries in 1982 to engage in activities permitted to holding company affiliates under Section 4(c)(8) would *not* authorize any securities activity prohibited to banks by the Glass-Steagall Act. *Accord* 128 Cong. Rec. S12215 (Sept. 24, 1982) (statement of Sen. Riegle).

68 *See Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 588 (1980) (where one of the other terms upon which a statutory construction relies may not connote the argued-for meaning, rule of *ejusdem generis* is inapplicable).

69 "Best efforts" underwriting is where a securities house "instead of *buying* the issue *from* the company and reselling it as principal, *sells* it *for* the company as agent." 1 Loss, *Securities Regulation* 171-172 (2d ed. 1961) (emphasis in original).

reason to construe the term "public sale" to include only principal, and not agency, activities.

Section 21 of the Act also uses the terms "issuing," "underwriting" and "distributing" in conjunction with the term "selling." Yet, plainly "selling" as used in Section 21 encompasses more than just principal activities. The floor manager in the House of the bill that was eventually to become the Glass-Steagall Act specifically described Section 21 as taking "brokers" out of the depository business. (*See*, *supra*, p. 21.) Furthermore, no reason exists to believe that Congress, which prohibited securities brokerage to member banks of the Federal Reserve System under Section 16, did not intend to do the same for non-member banks under Section 21.[70]

The reading given to Section 20 by the court below assumed that Congress intended the statutory terms in a limited, technical meaning. Yet, this Court has repeatedly instructed that the prohibitory terms of this remedial statute are *not* to be construed narrowly or accorded a technical meaning. *ICI* II, 450 U.S. at 65; *ICI* I, 401 U.S. at 635; *Board of Governors* v.

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70 The Board itself has argued to this Court that Sections 16 and 21 should be interpreted as co-extensive. Brief for Respondents at 21, *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766, *cert. granted* Oct. 3, 1983.

Indeed, a goal of Congress in enacting the Banking Act of 1933, and its 1935 amendments, was to achieve competitive parity between national and state banks. *See* 77 Cong. Rec. 3726 (1933) (remarks of Sen. Glass). It would be incongruous, therefore, if national banks and state-member banks, which are subject to Section 16, were prohibited from securities brokerage, while state non-member banks, which are subject only to Section 21, were not.

The legislative history of the Glass-Steagall Act suggests that separate sections were drafted to deal with national banks, state-member banks of the Federal Reserve System, and state non-member banks due to concern over the extent to which Congress had the constitutional authority to restrain activities of banks chartered by the state legislatures, especially if those banks had not chosen to become members of the Federal Reserve System. *See* S. Rep. No. 584, 72d Cong., 1st Sess. 10 (1933); *see also* 77 Cong. Rec. 3727 (1933) (remarks of Sen. Glass); 77 Cong. Rec. 4179 (1933) (remarks of Sen. Tydings). There is no indication whatsoever in the legislative history that separate sections were drafted so as to restrict different *types* of activities engaged in by these different institutions.

Agnew, 329 U.S. 441, 446-67 (1947); *cf. Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935).

Moreover, if Congress had intended to use statutory terms in their technical sense, presumably it would have done that throughout the Act; it did not do so. The term "dealer," for example, technically refers to someone who is acting in the capacity of a principal.[71] Section 16 of the Act, however, describes "the business of *dealing* in securities and stock," as purchasing and selling securities "upon the order, and for the account of customers," obviously referring to agency, not principal, activities. Congress used "dealing" in its broad, generic sense. There is no reason to believe Congress intended to use other terms in the Glass-Steagall Act in a technical, commercial sense.

The court below also sought support for its holding in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), concluding that this Court implicitly had determined the present issue in that action. *Agnew*, however, was a case concerning Section 32 of the Act, in which this Court did not, and did not have to, address the question of whether brokerage activities are prohibited for banks, or whether the term "public sale" should be construed consistently with the term "purchasing and selling" used elsewhere in the Act. Assuming that Section 32 covered the "underwriting" field, 329 U.S. at 445 n.3, this Court found a sufficient level of prohibited conduct to satisfy the "primarily engaged" standard of the Act there at issue.[72]

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71 *See*, 15 U.S.C. § 78c(a)(5) ("dealer" defined as one who buys and sells for his own account). As the Board put it in its Order, "[a] dealer is thus unlike a broker, which acts for the account of its customer." (148A n. 41.)

72 The court below also cited (162A) the pre-*Agnew* Board interpretation of Section 32 as excluding brokerage activities, to support its narrow reading of Section 20. 22 Fed. Res. Bull. 51 (1936). There is no reason, however, why only two sections of the Act (20 and 32) should be viewed in isolation from the remaining sections (16 and 21) when ascertaining Congressional intent. Moreover, in marked contrast to the Comptroller's contemporaneous construction of Section 16 of the Act (*see, supra*, pp. 22-25), there is no indication that the Board's construction of Section 32 was ever brought to Congressional attention, let alone that it led to Congressional action. Nor

Here, by contrast, the types of activities prohibited by the Glass-Steagall Act *are* at issue and, as noted in *ICI* II, 450 U.S. at 63, these include the activities of both "underwriters" and "brokerage houses." This Court certainly did not rule in *Agnew* that bank affiliates may engage *principally* in activities that are prohibited *entirely* for banks—the holding of the court below in this case.

The Court of Appeals did not cite *Agnew*, or for that matter any other case, in support of its holding in the latter respect. The court's rationale (168A) was as follows:

> We think, however, that the latitude the Act grants bank holding companies partially to engage in activities such as underwriting, which implicate the Act's policies whether conducted by banks or bank holding companies, suggests that bank holding companies can, under the Act, be allowed principally to engage in activities which pose the dangers the Act addressed only when conducted by banks.

No citation accompanied this holding because there is no precedent to support it. This marks the first time any court has ruled that the coverage of Section 20 depends, not simply upon whether the affiliate is engaged "principally" in activities prohibited by the Act, but upon an assessment of whether the activities involved "pose the dangers the Act addressed."

By this holding, the court effectively vested in the Board exemptive authority under Section 20 that Congress itself has withheld.[73] In marked contrast to Section 32 of the Act, which

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does, or could, anything suggest how the Board's interpretation furthered the underlying Congressional intent to separate banks from transactions in speculative securities. Like the administrative interpretation in *Zuber* v. *Allen*, *supra*, 396 U.S. at 193, the Board's Section 32 interpretation lacks those "props that serve to support a disputable administrative construction."

73 In adopting the Glass-Steagall Act Congress did consider, and reject, proposals merely to regulate, rather than prohibit, bank involvement in the securities business. *See* Willis and Chapman, *The Banking Situation* 68-69 (1934). At the urging of the Comptroller of the Currency and others Congress also considered a number of amendments to the Act during 1934-35, including proposals that were rejected which would have replaced

does permit the Board to exempt certain arrangements from the Act's management interlock provisions,[74] Section 20 vests no exemptive authority whatsoever in the Board to authorize prohibited securities activities for bank affiliates.[75]

In sum, public securities brokerage is among the prohibited activities covered by the Glass-Steagall Act. Banks therefore are prohibited from engaging in that activity at all and from affiliating with any organization principally engaged in it. For this reason, too, the decision below should be reversed.

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the Act's prohibitions with regulatory authority. *E.g.*, S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935). *See Generally* Brief of the Securities Industry Association at 22-25, *Securities Industry Ass'n.* v. *Board of Governors*, No. 82-1766, *cert. granted*, Oct. 3, 1983.

74 Section 32, 12 U.S.C. § 78, excepts:

> limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

75 The observation of the *National Courier* court, 516 F.2d at 1241, concerning application of the Bank Holding Company Act, under which the Board has some discretion, applies *a fortiori* to Section 20 of the Glass-Steagall Act, under which the Board has none:

> Congress did not instruct the Board to allow or disallow bank involvement in nonfinancial activities as may be required by the policies which counsel a separation of commerce and banking. Having heeded that counsel itself, it decreed a separation and instructed the Board to enforce it.

The court's analysis of Section 20 also disregards Congress' concern that affiliate losses and financial difficulties can "discredit the bank and impair the confidence of its depositors." 75 Cong. Rec. 9912 (1933) (remarks of Sen. Bulkley) *quoted in ICI* I, 401 U.S. at 632 n.26. This concern remains real, as underscored by recent testimony of Walter Wriston, Chairman of Citicorp, before the Senate Banking Committee:

> [I]t is inconceivable that any major bank would walk away from any subsidiary of its holding company. If your name is on the door, all of your capital is going to be behind it in the real world. Lawyers can say you have separation, but the marketplace is persuasive, and it would not see it that way.

Hearings on S.1686, S.1703, S.1720 & S.1721 Before Senate Comm. on Banking, Housing and Urban Affairs, 97th Cong., 1st Sess., Pt. II at 589-590 (1981).

III.

THE DECISION BELOW IMPROPERLY DEFERS TO AGENCY AMENDMENT OF LEGISLATIVE POLICY

The Court of Appeals defined its task as simply determining whether the Board's statutory interpretation was "reasonable." (160A.) The Court so limited its inquiry even though the Board has *no* rulemaking authority under relevant provisions of the Glass-Steagall Act,[76] and even though the Board's decision involves "the quintessential judicial function of deciding what a statute means."[77]

The matters at issue involve questions of law: the proper construction of the Glass-Steagall Act, and the correct meaning of the Bank Holding Company Act.[78] The courts have the "ultimate responsibility to construe the language employed by Congress,"[79] and "deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia which results in the unauthorized assumption by an agency of major policy decisions properly made by Congress."[80] As this Court recently

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76 *Cf. General Electric Co.* v. *Gilbert*, 429 U.S. 125, 141-42 (1976).

77 *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Authority*, ___ U.S. ___, 104 S. Ct. 439, 444-45 n.8 (1983). *See also Commissioner* v. *Engle*, 52 U.S.L.W. 403, 409 (U.S. Jan. 10, 1984); *Barlow* v. *Collins*, 397 U.S. 159, 166 (1970). The Administrative Procedure Act, of course, directs that agency action is to be set aside by the courts wherever it is found to be "not in accordance with law". 5 U.S.C. § 706(2)(A).

78 *See National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1236 (D.C. Cir. 1975) (construction of phrase "closely related" is a legal issue for the court to decide).

79 *Zuber* v. *Allen*, *supra*, 396 U.S. at 193; *See NLRB* v. *Brown*, 380 U.S. 278, 291-92 (1965).

80 *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Authority*, *supra*, 104 S. Ct. at 444 *quoting American Ship Building Co.* v. *NLRB*, 380 U.S. 300, 318 (1965). *See also International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 & n.20 (1979).

stressed, policy determinations "must be implemented by Congress and not by a crabbed [administrative] interpretation of the words of the statute."[81] *BankAmerica Corporation* v. *United States*, ___ U.S. ___, 103 S. Ct. 2266, 2273 (1983).

The Board here sanctioned an unprecedented "[e]xpansion of banking into securities activities" (155A), unquestionably a major policy decision. This administrative "expansion" is especially significant because Congress itself is considering legislative proposals to revise existing statutory restrictions on financial institutions.[82] In each of several recent sessions Congress has enacted major revisions of the federal banking laws,[83]

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81 This is especially true with respect to the interrelated statutory structure governing financial institutions, which has been disrupted substantially by recent piecemeal administrative alterations. The entry of banks into brokerage thus has forced the Securities and Exchange Commission, in the interest of investor protection, to propose rules extending its jurisdiction over banks that "publicly solicit brokerage business." 48 Fed. Reg. 51,930 (Nov. 15, 1983). The American Bankers Association has challenged the power of the SEC to adopt the proposed rule. 42 Wash. Fin. Rep. (BNA), No. 2 at 76 (Jan. 9, 1984).

Similarly, after the Board acted to exempt commercial paper from the definition of "security" as used in the Glass-Steagall Act, 46 Fed. Reg. 29333 (June 1, 1981), the Federal Energy Regulatory Commission and the Securities and Exchange Commission were each required to issue temporary exemptions from interrelated provisions in the statutes they administer. *See* 46 Fed. Reg. 19980 (April 2, 1981); 46 Fed. Reg. 18535 (March 25, 1981).

82 *See, e.g.*, Financial Institutions Deregulatory Act, S. 1609 and H.R. 3537, 98th Cong., 1st Sess. (1983), which would substantially expand existing powers of bank holding companies. In addition to this proposal, Congress currently is considering legislation to revise the federal deposit insurance system, ban the acquisition of banks by non-depository institutions, restructure the federal system for regulating financial institutions and reform the requirements of membership in the Federal Reserve System. *See* 42 Wash. Fin. Rep. (BNA) No. 6 at 261 (Feb. 6, 1984); 41 Wash. Fin. Rep. (BNA) No. 10 at 326 (Sept. 12, 1983).

83 *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

but in each instance Congress itself has determined not to relax existing restrictions on bank securities activities. To the contrary, Congress repeatedly has reaffirmed its support of existing Glass-Steagall Act restrictions by, for example:

—stressing that new rulemaking authority granted the Comptroller does *not* extend to issuing regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act';"[84] and

—confirming that new powers given to bank subsidiaries do *not* authorize "any securities activity that is prohibited to banks or bank holding companies under the Glass-Steagall Act."[85]

Nevertheless, reacting to pressures from the entities they regulate, federal banking agencies have been paring back, slice by slice, the existing statutory limitations. For example, although the Board at present has barred the addition of "investment advice" to discount brokerage (155A), two other bank regulatory agencies have already authorized entities under their supervision to combine brokerage with investment advice.[86] Nor have the recent administrative reinterpretations been lim-

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84 *See* 12 U.S.C. § 93a adopted as part of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980).

85 S. Conf. Rep. 641, 97th Cong., 2d Sess. 92 (1982), commenting on section 709 of the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132.

86 *See Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas to Establish an Operating Subsidiary to Provide Investment Advice* (Sept. 2, 1983); *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, et al.* (May 6, 1982). These decisions are currently subject to challenge before the courts. *See Securities Industry Ass'n* v. *Conover*, No. 83-3581 (D.D.C., filed Nov. 30, 1983); *Securities Industry Ass'n* v. *Federal Home Loan Bank Bd.*, No. 82-1920 (D.D.C. filed July 12, 1982).

ited to brokerage. One bank agency has even ruled that shares in bank-operated collective investment funds do not constitute "securities," and so may be underwritten by banks, despite this Court's contrary holding in *ICI* I.[87]

Much of this has a sense of déjà vu to it. Many of the arguments advanced today to defend regulatory expansion of bank activities echo the contentions of those who proposed the McFadden Act of 1927 in order to permit national banks to deal in investment securities. There, too, it was argued that the banks needed authority "to give the most complete modern banking service" and to compete effectively with other financial institutions.[88] Less than ten years later the economy had collapsed, thousands of banks had failed, and the President had declared a national bank holiday. Congress then removed securities powers included in the McFadden Act. Bank regulators should not now be free to "reinterpret" Congressional actions in a manner that defeats the result intended—removal of banks from the securities business.

The opinion below, if allowed to stand, will signal to the lower federal courts and to other bank regulators that the "[e]xpansion of banking into securities activities" (155A) may continue apace, without any Congressional action on the fundamental policy changes being implemented. It should be reversed.

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87 *Decision of the Comptroller of the Currency on the Application by Citibank to Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts* (October 28, 1982).

88 H.R. Rep. No. 583, 68th Cong., 1st Sess. 1 (1924); *see* 67 Cong. Rec. 2845 (1926).

CONCLUSION

For each and all the reasons set forth above, the decision of the Court of Appeals should be reversed, and the case remanded with directions to vacate the Board's Order of January 7, 1983 as null and void and to direct respondent BAC to divest itself of Schwab.

Dated: March 6, 1984

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No. 83-614

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, PETITIONER

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS

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QUESTIONS PRESENTED

1. Whether the Board of Governors of the Federal Reserve System properly determined that a company that executes orders to buy and sell securities solely for the account of customers and not for its own account is engaged in an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8).

2. Whether the Board of Governors correctly concluded that a company that executes orders to buy and sell securities solely for the account of customers and not for its own account is not engaged principally in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377.

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BRIEF FOR THE FEDERAL RESPONDENTS

OPINIONS BELOW

The opinion of the court of appeals (J.A. 157a-176a) is reported at 716 F.2d 92. The order of the Board of Governors of the Federal Reserve System (J.A. 125a-156a) is reported at 69 Fed. Res. Bull. 105. The Recommended Decision of the administrative law judge (J.A. 5a-122a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on July 15, 1983, and amended on September 20, 1983. The petition for a writ of certiorari was filed on October 13, 1983, and was granted on January 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are set forth at J.A. 177a-184a.

STATEMENT

Section 4(c)(8) of the Bank Holding Company Act of 1956 (the Act), 12 U.S.C. 1843(c)(8), authorizes the Federal Reserve Board to permit bank holding companies, as defined therein,[1] to engage directly or through subsidiaries in nonbanking activities if the Board determines by order or rule that the activity is "so closely related to banking as to be a proper incident thereto." The Board's determination that an activity is "closely related to banking" and thus is permissible for bank holding companies generally, does not, by itself, authorize any particular bank holding company to engage in that activity. The Board must also determine whether the public benefits reasonably expected to result from performance of the activity by the particular holding company outweigh any possible adverse effects. See *Board of Governors* v. *Investment Company Institute* (*ICI II*), 450 U.S. 46, 56 & n.22 (1981); see Regulation Y, 49 Fed. Reg. 794,824 (1984), to be codified at 12 C.F.R. 225.23(a). In addition, the Board may not approve the application if the activity is one barred to bank affiliates by Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which proscribes, as a principal business, the "issue, flotation, underwriting, public sale, or distribution" of securities.

1. On February 8, 1982, BankAmerica Corporation (BankAmerica), a bank holding company within the meaning of the Bank Holding Company Act, applied to

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[1] A "bank holding company" is defined in Section 2(a)(1) of the Bank Holding Company Act of 1956, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [inter alia] the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *." At the time of the Board's order, BankAmerica controlled one bank, Bank of America N.T. & S.A., San Francisco, California (J.A. 127a).

the Federal Reserve Board pursuant to Section 4(c)(8) of the Act for permission to acquire The Charles Schwab Corporation and its wholly-owned brokerage subsidiary, Charles Schwab & Co., Inc. (Schwab) (J.A. 11a). Schwab is a "discount" securities brokerage firm; it effects purchases and sells securities solely on the order and for the account of customers (J.A. 17a-19a, 127a). Unlike traditional brokerage firms, Schwab does not make a market for, deal in, or underwrite securities. Schwab generally charges commissions on the securities transactions it executes for its customers at rates significantly lower than the commissions charged by full-line brokers, which ordinarily include investment advice as part of their fees (*ibid.*).[2] After the acquisition, Schwab remains a separately incorporated broker, registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934, 15 U.S.C. 78o.

The Board published notice of BankAmerica's application and requested comments from the public (47 Fed. Reg. 16104 (1982)). Comments on the application were received from 99 sources. The Comptroller of the Currency and the Department of Justice both submitted comments supporting the proposal (J.A. 125a). Petitioner, a trade association representing over 90% of the securi-

[2] From their inception, the nation's stock exchanges prohibited their member brokers from charging commissions at rates lower than those set by the exchanges. See generally, *Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 663-672 (1975). Effective May 1, 1975, the SEC prohibited the fixing of commission rates thereby allowing competition among brokerage firms in the rates they charge. *Id.* at 673-682. Under fixed rates customers paid a single commission fee regardless of whether they received the investment research and other services for which the fixed fee was designed to compensate brokers. The initiation of competitive commission rates has permitted brokers to match fees to the services actually provided to the customer. See SEC, *Fifth Report to Congress on the Effect of the Absence of Fixed Rate of Commissions* 11, 47-50 (1977).

ties firms in this country, objected to the proposed acquisition and requested a formal hearing on the application. The request was granted by the Board and a formal hearing was held before an administrative law judge in September 1982.[3]

2. On November 12, 1982, the Administrative Law Judge (ALJ), on the basis of an exhaustive administrative record, issued a 164-page Recommended Decision, recommending that the Board approve BankAmerica's application (J.A. 5a-124a). The ALJ concluded that the Glass-Steagall Act does not prohibit a bank holding company from engaging in discount brokerage activities by acquiring a discount broker, such as Schwab (J.A. 67a-76a). In addition, the ALJ found that Schwab's discount brokerage and related activities are "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act (J.A. 76a-87a), and that, as required by Section 4(c)(8), BankAmerica's acquisition of Schwab would result in public benefits that outweigh any adverse effects from the proposal (J.A. 87a-118a).

The Board approved BankAmerica's application to acquire Schwab, adopting with only minor modifications the ALJ's Recommended Decision (J.A. 125a-156a). The Board first concluded that Schwab's discount brokerage and related activities are so closely related to banking as to be a proper incident thereto within the meaning of Section 4(c)(8) (J.A. 128a-133a). The Board found that many banks provide securities brokerage services (J.A. 129a). Although Schwab's activities differ somewhat from the services usually performed by banks, primarily because Schwab executes orders directly on stock exchanges, the Board found that banking services in connection with securities generally and Schwab's activities in particular were strikingly similar and moreover

[3] The Chief Administrative Law Judge of the Federal Trade Commission presided at the hearing, pursuant to the provisions of 5 U.S.C. 3344.

that banking organizations are particularly well equipped to engage in the type of automated brokerage activities in which Schwab specializes (J.A. 129a-132a).

In addition, as required by Section 4(c)(8), the Board found that BankAmerica's proposed acquisition of Schwab could reasonably be expected to produce public benefits in the form of increased competition, convenience, and efficiency in the provision of retail brokerage services. The Board found on the other hand that the acquisition would cause no significant adverse effects, such as undue concentration of resources, or decreased or unfair competition with traditional brokerage firms (J.A. 133a-146a).

Finally, the Board concluded that since Schwab effects securities transactions only as agent for retail customers and not for its own account, Schwab is not engaged in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which prohibits members of the Federal Reserve System from being affiliated with an organization engaged principally in such activities. Therefore, the Board concluded that BankAmerica's proposed acquisition of Schwab would not result in an affiliation barred by Section 20 (J.A. 147a-153a). In response to petitioner's contention that Schwab's activities are not permissible under Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, the Board stated that Section 16 by its terms does not apply to the activities of bank holding companies; it is limited to banks. Moreover, the Board noted that Section 16 permits banks to purchase and sell securities and stock without recourse, solely upon the order, and for the account of, customers, and that the Comptroller of the Currency has interpreted Section 16 as authorizing national banks to engage in retail securities brokerage (J.A. 149a-151a).

3. The court of appeals affirmed the Board's order (J.A. 157a-176a). On the issue of the meaning of Section 20 of the Glass-Steagall Act, the court of appeals

agreed with the Board's conclusion that Schwab's brokerage services do not constitute the "public sale" of securities (J.A. 161a-169a). The court reasoned that Section 20 refers only to activities in connection with the widespread marketing of securities as principal and not to the type of retail brokerage transactions Schwab executes for its customers (J.A. 161a). The court of appeals found support for this interpretation in the Board's longstanding construction of language identical to Section 20's contained in Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, which the Board interpreted as not including mere brokerage activities (J.A. 162a-163a). Moreover, the court of appeals found that the Board's reading of Section 32 had been implicitly approved by this Court in *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441 (1947) (J.A. 160a-163a). The court rejected petitioner's contention that Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, which limits a national bank to "purchasing and selling" securities "without recourse" upon the order and for the account of customers, and not for its own account, implicitly imposes restrictions on bank affiliates identical to those it expressly imposes on banks (J.A. 167a-169a).

The court also agreed with the Board's holding that Schwab's brokerage activities satisfy the "closely related" test of Section 4(c)(8) of the Bank Holding Company Act (J.A. 169a-175a). The court upheld as "clearly" supported by substantial evidence the Board's findings that banks "widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading" (J.A. 171a-172a). The court rejected petitioner's contention that the Board had applied the wrong legal standard by not requiring that the proposed non-banking activity actually "facilitate" some preexisting banking operations for all banks. The court of appeals held that this Court's decision in *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46 (1981), implicitly rejected petitioner's strict "facilita-

tion" argument by focusing on the relationship between the nonbanking activity at issue and traditional banking practices (J.A. 173a-174a). Finally, the court of appeals rejected petitioner's challenge to the Board's findings that "the public benefits reasonably to be expected from [BankAmerica's] acquisition of Schwab will outweigh the possible adverse effects" (*id.* at 175a-177a).

SUMMARY OF ARGUMENT

I A.

The language and structure of Section 4(c) of the Banking Holding Company Act of 1956, 12 U.S.C. 1843 (c), indicate clearly that Congress delegated to the Federal Reserve Board broad authority to use its experience and knowledge in deciding what types of nonbank activities are "so closely related to banking" that they may properly be performed by bank holding companies directly or through nonbank subsidiaries. Congress, in the 1970 amendments to Section 4(c)(8), made plain its intention to invest the Board with "maximum flexibility" to make decisions under that provision. 116 Cong. Rec. 42432 (1970) (quoted in *Board of Governors* v. *Investment Company Institute* (*ICI II*), 450 U.S. 46, 58 n.23 (1981)). Congress recognized that the Board's expertise in financial matters makes it uniquely suited to assure that banks and bank holding companies can engage in new types of banking-related services or opportunities in order to satisfy the financial needs of the public. Nothing in the Act or its history supports petitioner's claim that the Board must disapprove a bank holding company's application to pursue a new business opportunity, even though the proposed activity has a close operational and functional similarity to the activities of banks and banks are particularly well suited to perform that function.

B.

The Board's analysis of the relationship between discount brokerage services and banking in this case is indistinguishable from this Court's analysis in *ICI II*, *supra*, of the relationship between operating and managing a closed-end investment company and traditional banking activities. This Court noted that the proposed activity was "not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. Similarly, Schwab's brokerage services as agent for its clients are virtually identical to a variety of banking services.

Nor has any court of appeals that has interpreted Section 4(c)(8) attempted arbitrarily to cabin the Board's discretion by requiring it to show some nexus between a proposed activity and banking that is closer than the "operationally and functionally similar" test consistently adhered to by the Board since 1970. See, e.g., *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975). Those courts and the Board have found that this approach is well suited to the judgmental task of deciding whether a particular nonbank activity will serve the public's needs, while still maintaining the line Congress drew between banking and commerce.

C.

The fundamental flaw in petitioner's challenge to the standard applied by the Board is that it diverts attention from the real issues before the Court, viz., whether, regardless of what words are used to describe the relationship, the Board has "articulate[d] the ways in which banking activities and the proposed activities are assertedly connected" and whether it is rational to conclude that the connection is close. *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237. There can be no doubt that the Board's findings satisfy that standard in this case; banks have been purchasing and selling securi-

ties for their customers' accounts for decades and are undeniably well equipped to perform the type of brokerage activity Schwab specializes in. The Board's decision to approve BankAmerica's application is therefore proper under Section 4(c)(8) of the Bank Holding Company Act.

II A.

The Glass-Steagall Act contains only one provision that is relevant to the securities activities of bank holding companies and their nonbank subsidiaries; Section 20, 12 U.S.C. 377, prohibits them from engaging "principally in the issue, flotation, underwriting, public sale, or distribution" of securities. On its face, it is plain that this provision is directed exclusively at the widespread marketing of large blocks of securities to the public.

Congress was not concerned with mere brokerage transactions when it adopted Section 20 of the Glass-Steagall Act in 1933. It was responding to the underwriting activities of bank securities affiliates in the 1920's that created the speculative investments that in turn consumed so much of bank depositors' money and caused banks to fail when the securities market collapsed. S. Rep. 77, 73d Cong., 1st Sess. 8 (1933); 77 Cong. Rec. 3954 (1933). Executing stock transactions by itself did not cause any bank to fail and Congress did not prohibit such conduct in Section 20.

The Board first interpreted the pivotal language in Section 20 as referring only to underwriting and not to brokerage activities in 1936 (22 Fed. Res. Bull. 51 n.1) (albeit in connection with the identical wording of Section 32 of the Glass-Steagall Act, 12 U.S.C. 78), and the Board has not modified that interpretation since. See 12 C.F.R. 218.1 n.1. As an aid to interpreting Section 20, the Board's regulation construing Section 32 is entitled to great weight by this Court. See *Northcross* v. *Board of Education*, 412 U.S. 427 (1973); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980).

That the language in Section 20 plainly does not embrace brokerage services is demonstrated by this Court's treatment of the same language in Section 32 of the Glass-Steagall Act in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947). There the Court repeatedly described the statute as involving underwriting. Moreover, the Court would not have been obliged to decide whether the securities firm involved in that case was "*primarily* engaged" in the "public sale" of securities if that term included brokerage activities; virtually every securities firm is "primarily engaged" in some combination of underwriting and brokerage activities.

B.

Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, is not relevant to deciding what bank holding companies may do in connection with securities. By its terms that section applies only to banks. It makes a mockery of the plain meaning rule for petitioner to argue, notwithstanding Section 16's direct reference to banks and its use of language fundamentally different from Section 20's in describing the securities activities open to banks, that the provision should be incorporated into Section 20 and thereby impose additional limitations not included therein. See *Russello* v. *United States*, No. 82-472 (Nov. 1, 1983). Moreover, nothing in the legislative history indicates that Congress intended these two sections to impose identical restrictions, and this Court already has held that the structure of the Act "reveals a congressional intent to treat banks separately from their affiliates." *ICI II*, 450 U.S. at 59 n.24.

C.

Even if, contrary to our prior contention, Section 16 does apply to bank holding companies, Schwab's brokerage activities are within the activities authorized by Section 16. Schwab purchases and sells securities "upon the order, and for the account of, customers, and in no case for its own account." 12 U.S.C. 24 Seventh. The refer-

ence to "customers" in the statute merely means that the bank must act as an agent and never as principal in the purchase and sale of stock. This is consistent with Congress's intention in 1933 to permit banks to purchase and sell securities "to the same extent as heretofore," S. Rep. 77, 73d Cong., 1st Sess. 16 (1933); banks had executed sales for persons who were not otherwise their customers prior to 1933.

The only support for petitioner's claim that Section 16 limits a bank's authority to sell stock as agent to customers of the bank's other services is that the Comptroller adopted this construction in 1936. The Comptroller of the Currency has now rejected the earlier interpretation that Section 16 contains an independent customer requirement. The Comptroller explained that the prior ruling was not compelled by the language of the statute, that the basis for the prior limitation was never explained and that in light of experience the old rule appeared to embody an unduly conservative approach not intended or ever ratified by Congress. Since the Comptroller fully explained the reasons for departing from the earlier rulings, and since that departure is clearly consistent with the statute, the Comptroller's present interpretation is entitled to deference by this Court. *American Trucking Ass'n* v. *Atchison, T. & S.F. Ry.*, 387 U.S. 397 (1967). Under the Comptroller's interpretation of Section 16, banks are clearly permitted to engage in discount brokerage activities; it follows, *a fortiori*, that a bank holding company may.

ARGUMENT

In 1975, for the first time in the long history of the New York Stock Exchange and the other smaller exchanges, the brokerage commission rates—the fees investors pay brokers to execute securities trades—were unfixed by an order of the Securities and Exchange Commission. See note 2, *supra*. The natural and expected consequence of the SEC's decision was the emergence of

the "discount brokerage firm" as a viable financial institution. What this case involves is the quintessential administrative responsibility—indeed the very raison d'etre for creating administrative agencies—to adjust and apply preexisting requirements and prohibitions in the statute an agency administers to new forms of commercial opportunity. With the benefit of an exhaustive record, the Federal Reserve Board has taken a hard look at the relationship between discount brokerage activities and traditional banking activities and concluded in a thoughtful and reasoned opinion that the former are so closely related to the latter that integrating those activities under the umbrella of a holding company will not blur the line that Congress drew in the Bank Holding Company Act between banking and other forms of commerce. In addition, the Board concluded that the new business of discount brokerage is not prohibited by the 50-year old ban on "public sales," in Section 20 of the Glass-Steagall Act, which was intended solely to keep bank holding companies and their nonbank subsidiaries out of the underwriting business.

Contrary to petitioner's charge (Pet. Br. 43-46), this case is not an example of an agency retreating from the task Congress assigned to it to maintain the integrity of banking and preserve its segregation from ordinary forms of commerce. The Federal Reserve Board has carefully and faithfully carried out the missions Congress assigned to it, and petitioner's vague assertions about faithless regulators based on actions of other administrative agencies in other contexts simply have no relevance to the Board's order in response to BankAmerica's application. The Board's interpretation of the statutes it administers is reasonable and the factual basis for its conclusions is not even disputed by petitioner. By any standard of judicial review of agency decision making, the decision below approving BankAmerica's application to acquire Schwab should be affirmed.

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I. THE FEDERAL RESERVE BOARD PROPERLY CONCLUDED THAT DISCOUNT BROKERAGE SERVICES ARE CLOSELY RELATED TO BANKING WITHIN THE MEANING OF SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT

Section 4(c)(8) of the Bank Holding Company Act of 1956 authorizes the Federal Reserve Board to permit bank holding companies to acquire substantial ownership interests in other companies if the Board determines that the acquired company's business is "so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. 1843(c)(8).[4] The Board's order approving BankAmerica's acquisition of Schwab and the recommended decision adopted by the Board contain detailed findings concerning the securities brokerage services now being provided by banks (J.A. 25a-36a; 129a-132a). Based on these findings the Board determined that Schwab's discount brokerage services are "operationally and functionally very similar to the

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[4] A bank holding company must satisfy two tests under Section 4(c)(8) of the Bank Holding Company Act in order to engage in nonbank activities under that section. First, the activity must be "closely related to banking." Section 4(c)(8) also establishes a second, so-called "proper incident" test, which requires a bank holding company to establish to the Board's satisfaction that its performance of the related nonbank activity "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." 12 U.S.C. 1843(c)(8). See H.R. Rep. 91-1747, 91st Cong., 2d Sess. 21 (1970); *Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551-552 (7th Cir. 1978).

In its order approving BankAmerica's acquisition of Schwab, the Board concluded, based on extensive and detailed evidentiary findings, that the "proper incident" test was satisfied with respect to all of Schwab's activities (J.A. 133a-146a). Petitioner challenged those findings in the court of appeals, but the court concluded that they were "plainly reasonable" (J.A. 175a), and petitioner has not renewed its challenge on this issue in this Court.

types of brokerage services that are generally provided by banks" and that "banking organizations are particularly well equipped to provide" the kind of securities brokerage services offered by Schwab (J.A. 129a). Accordingly, the Board concluded that Schwab's discount brokerage activities satisfy the "closely related to banking" test of Section 4(c)(8) (J.A. 131a, 146a).[5]

Petitioner does not contend that the Board's findings are not supported by substantial evidence, but rather asserts (Pet. Br. 12-19) that the Board applied an erroneous legal standard in determining that Schwab's discount brokerage activities are "closely related to banking." To the contrary, the close functional and operational similarity test applied by the Board in this case is consistent with the language, legislative history and longstanding judicial and administrative interpretations of Section 4(c)(8), and therefore was properly upheld by the court of appeals.

A. The Language, Structure And Legislative History Of Section 4(c)(8) Indicate That The Board Has Discretion To Determine That A Bank Holding Company May Engage In Discount Brokerage Activities Through A Subsidiary

1. Congress made no attempt in the Bank Holding Company Act to designate what types of nonbanking activities it intended bank holding companies to be permitted to undertake or those it intended to prohibit; certainly nothing in the Act prohibits securities brokerage activities. Instead, it left those determinations to the discretion of the Board, and, contrary to petitioner's claim (Pet. Br. 13), the language and structure of Section 4(c) indicate that the authorization granted was intended to be more than a trivial one. Since the Act "requires divestment

[5] In its order, the Board also concluded that Schwab's margin lending, securities custodial, and account maintenance services satisfy the "closely related to banking" test based on findings that banks generally offer the same or functionally identical services (J.A. 132a-133a). These findings are not contested by petitioner.

only of nonbanking interests, the § 4(c)(8) exception would be unnecessary if it applied only to services that a bank could legally perform." *ICI II*, 450 U.S. at 64. Thus, Section 4(c)(8) must allow bank holding companies to enter into activities in which banks themselves may not. In addition, since Section 4 of the Act contains an independent exemption for performing services for subsidiary banks, see 12 U.S.C. 1843(c)(1)(C),[6] the nonbanking services embraced by Section 4(c)(8) must extend beyond operations that are essential or contribute significantly to the achievement of some preexisting banking function. Otherwise, Section 4(c)(8) would be rendered superfluous. Indeed, if Congress had intended for the nonbank activities to involve nothing more than essentially preexisting banking activities, it is difficult to understand why it would have bothered to adopt the "proper incident" test, which requires the Board to engage in a wide ranging inquiry into the benefits and adverse effects of permitting a particular bank holding company to enter a new field of closely related endeavor. Compare 12 U.S.C. 1843(c)(1)(C) (contains no proper incident requirement).

Section 4(c)(8) on its face is simply not susceptible to the crabbed interpretation of the Board's discretion petitioner proposes. Under a "normal reading" of the statute (see *ICI II*, 450 U.S. at 56), nonbanking activities that are "closely related to banking" must embrace at

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[6] The legislative history of the Act confirms that the authority granted bank holding companies by Section 4(c)(8) (then Section 4(c)(6)) to engage, after Board approval, in "closely related" nonbank activities, was intentionally broader than the servicing authority granted by Section 4(c)(1)(C). See S. Rep. 1095 (Pt. 2), 84th Cong., 2d Sess. 3 (1956). The Board has interpreted the Section 4(c)(1)(C) exemption as including companies that act "to *facilitate operations* of one or more of the subsidiary banks." *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess., Pt. 1, at 141 (1970) (testimony of Arthur Burns) (emphasis added).

least those services performed by nonbanks that have a close operational and functional similarity to activities ordinarily performed by banks.

2. Although the legislative history "provides no real guidance as to the scope of the exception" in Section 4(c)(8) (*ICI II*, 450 U.S. at 56 n.20), it nevertheless makes plain that the Board was invested with a significant amount of flexibility in identifying the types of relationships that satisfy the "closely related" requirement of that section. See *id.* at 76 & n.58. Section 4(c)(6) of the original 1956 Act (now Section 4(c)(8))[7] authorized bank holding companies to engage in activities "of a financial, fiduciary, or insurance nature * * * which the Board * * * by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act." 70 Stat. 137 (1956). The report of the Senate Committee on Banking and Currency accompanying the legislation explained (S. Rep. 1095 (Pt. 1), 84th Cong., 1st Sess. 13 (1955)):

> [T]here are many * * * activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason, your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

In 1970, Congress amended Section 4(c)(8) in a manner that "[o]n its face * * * would appear to have

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[7] Section 4(c)(6) was renumbered as Section 4(c)(8) by the 1966 amendments to the Bank Holding Company Act. See 80 Stat. 238.

broadened the Board's authority to determine when an activity is sufficiently related to banking to be permissible for a nonbanking subsidiary of a bank holding company" (*ICI II*, 450 U.S. at 72-73 (emphasis added)). Congress deleted the words "the business of" from Section 4(c)(8) and thereby "eliminated the requirement that bank holding companies show a close connection between a proposed activity and an activity in which the holding company or its subsidiary already actually engaged. Thus, the 1970 amendment to § 4(c)(8) permitted bank holding companies to engage in any activities closely related to activities generally engaged in by banks." 450 U.S. at 73 n.51.[8]

This Court noted in *ICI II* that the 1970 amendments to Section 4(c)(8) "were not intended to cut back on the discretion afforded the Board," but rather to maintain "'maximum flexibility for the Federal Reserve Board to determine the activities in which a bank holding company and its subsidiaries may engage * * *.'" 450 U.S. at 58 n.23 (quoting 116 Cong. Rec. 42432 (1970) (remarks of Sen. Bennett)). "As Senator Sparkman stated regarding the conference agreement: 'We reached a deci-

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[8] In 1970, Congress also amended the Bank Holding Company Act expressly to prohibit tie-ins between banking and nonbanking services offered by bank holding company subsidiaries. See Section 106(b) of the Bank Holding Company Act Amendments of 1970, 84 Stat. 1766. See also 12 C.F.R. 225.4(c)(1). This amendment prohibits arrangements whereby the obtaining of credit or some other service from a banking subsidiary of a bank holding company is in any way tied to or conditioned upon obtaining any other credit or service from the bank's holding company or any of that holding company's bank or nonbank subsidiaries. The amendment is inconsistent with a construction of Section 4(c)(8), such as that urged by petitioner (Pet. Br. 15), that in effect *requires* a bank holding company applying for Board authorization under that Section to show that the proposed nonbank services would only be offered to "customers" utilizing the separate services of the holding company's subsidiary. See *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1239 (D.C. Cir. 1975).

sion that the whole thing ought to be flexible, that it ought to be lodged in the hands of the Federal Reserve Board to carry out the guidelines we set.' 116 Cong. Rec. 42429 (1970)." 450 U.S. at 76 n.58.

In this regard, the amendment was the product of Congress's recognition that it is "essential that banks and bank holding companies have the flexibility to engage in new types of bank-related activities that may be needed now and in the future if the financial needs of the people are to be met efficiently, competitively and at reasonable cost." 116 Cong. Rec. 31822 (1970) (remarks of Sen. Sparkman). See also *id.* at 32130 (remarks of Sen. Bennett); *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess., Pt. 1, at 196 (1969) (remarks of William McChesney Martin, Jr.) (purpose of proposal is to "encourage innovation by * * * multibank holding companies in offering services to the public"). Thus, the Board's determination that bank holding companies may be permitted to engage in discount brokerage activities—a new commercial opportunity—because they are closely related to banking is precisely the kind of decision Congress envisioned the Board should make when it modified Section 4(c)(8) in 1970.

3. Remarkably, petitioner interprets (Pet. Br. 14-15) the legislative history of Section 4(c)(8) as completely repudiating the Board's analysis here. Petitioner's version of the 1970 amendments, however, involves a serious mischaracterization of what Congress clearly intended to achieve by those amendments and the standard the Board applied in this case.[9]

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[9] The other legislative materials relied upon by petitioner (Pet. Br. 13-14) are not persuasive evidence that Congress intended the Board's authority to be severely restricted. The report of the House Committee accompanying the original Act, H.R. Rep. 609, 84th Cong., 1st Sess. 16-17 (1955), is inapposite since the legislation reported by the House Committee contained *no* authorization for closely related nonbank activities. The language cited by petitioner

Prior to the 1970 amendments, the Board had interpreted the words "closely related to the *business* of banking" as requiring a "direct and significant connection" between the nonbank activities authorized by that section and the business operations of the applicant bank holding company's banking subsidiaries. See *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess., Pt. 1, at 196, 199 (1969) (testimony of William McChesney Martin, Jr.); see also *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 147 (1970) (testimony of Arthur Burns). The Board proposed that Congress amend the statute to liberalize its sweep by substituting a "functionally related to banking" standard. As the Chairman of the Federal Reserve Board explained, "one of the reasons we recommended that 'closely related' be changed to read 'functionally related' in the statute [was that] we wanted to avoid perpetuating the concept that a nonbank subsidiary's business must be related to the business of an affiliated bank." 116 Cong. Rec. 41959 (1970); *id.* at 42423.

Both the House and Senate passed bills that included the "functionally related" standard, but the Conference Committee deleted it. From this deletion petitioner infers that Congress intended to eliminate the Board's dis-

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refers instead to the exemption for servicing activities now codified at Section 4(c)(1)(C) of the Act, as contained in the House bill. Compare H.R. 6227, 84th Cong., 1st Sess. § 6(a) and (c) (1955); see note 6, *supra*. The remarks of Senator Capehart merely discuss the prohibition against nonbanking activities generally and do not purport to define the scope of the exception for activities determined by the Board to be "closely related to banking." 102 Cong. Rec. 6933-6939 (1956). Finally, the remarks of Senator Robertson cited by petitioner cannot be read too literally, because he also was of the view, shared by the rest of Congress, that as originally enacted, Section 4(c)(8) (then Section 4(c)(6)) was intended to give bank holding companies "liberal allowance" to engage in nonbanking activities. See 102 Cong. Rec. 6755 (1956).

cretion to consider in any way "functional relationships" between banking and nonbanking activities. But the conferees in both the House and the Senate in urging approval of their compromise relied upon the opinion of Chairman Burns that the Board's "objective" of having greater flexibility in making Section 4(c)(8) determinations would be served adequately if Congress simply removed the reference to "the business of" banking in the existing statute (116 Cong. Rec. 41959 (1970); *id.* at 42423), which Congress did. This history hardly supports an interpretation that Congress was narrowly confining the scope of activities the Board should consider under Section 4(c)(8). Compare *ICI II*, 450 U.S. at 73 ("[w]hether this [history] indicated that § 4(c)(8) was to have the same scope as it did under the 1956 Act is difficult to discern") with 116 Cong. Rec. 42429 (1970) (remarks of Sen. Bennett) ("the new language of section 4(c)(8) clearly gives the Federal Reserve Board broader discretion than it now has to make determinations of permissible activities").[10]

Moreover, petitioner's contention—that the close functional similarity standard employed by the Board is unwarranted—rests exclusively on the fortuity that the proposed amendment and the Board's approach both use the word "functional." But the "functionally related" to banking test proposed in 1970 is not the same as the "close operational and functional similarity" standard applied in this case. Arguably, the "functionally related" test in 1970 could have been understood as embracing nonbank activities bearing any relationship to functions performed by banks. By contrast, the test employed by the Board in this case is far more restrictive; the Board requires that the proposed nonbank activities either be

[10] The amendment clearly was intended to free the Board from its prior use of a "direct and significant connection" test. 116 Cong. Rec. 41959 (1970); *id.* at 42423. Thus, petitioner's attempt (Pet. Br. 14-15) to incorporate that standard into Section 4(c)(8) is wholly inconsistent with the 1970 amendments to the Bank Holding Company Act.

performed by banks or be so operationally and functionally similar to banking functions that banks generally are particularly well equipped to perform them (J.A. 128a, 129a, 132a-133a). It simply does not follow from Congress's refusal in 1970 to substitute a bare "functionally related" test for the arguably more restrictive "closely related" test that any reliance by the Board on functional relationships in applying Section 4(c)(8) is henceforth impermissible.

B. The Board's Determination That Discount Brokerage Activities Are Closely Related To Banking Is Consistent With The Interpretation Of Section 4(c)(8) Adopted By This Court And By Every Court Of Appeals That Has Considered The Issue

The correctness of the test applied below is further demonstrated by the uniform judicial construction of the "closely related to banking" language of Section 4(c)(8). In *ICI II*, this Court deemed it sufficient for purposes of the "closely related" test to note that providing investment advisory services to registered investment companies was not "significantly different from the traditional fiduciary functions of banks," 450 U.S. at 55, and therefore satisfied the "plain language" of Section 4(c)(8). 450 U.S. at 58, 78. The Court made no finding that banks actually performed the activity there at issue; instead, the Court noted the fact that banks have traditionally managed customers' investments and, in particular, have administered common trust funds that are very similar in function to investment companies (450 U.S. at 55-56). The Court's opinion in *ICI II* contains *no* reference to any requirement that the activity "facilitated," "supported," or was otherwise "essential" or "directly connected" to the operations of any bank. The Board's legal analysis here is indistinguishable from the legal analysis of this Court in *ICI II*.[11]

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[11] Petitioner attempts (Pet. Br. 16) to distinguish *ICI II* on the basis that the activity in that case "was a banking activity." But

Moreover, every court of appeals that has decided the issue—including the court below—has recognized that the Board may permit nonbanking activities under Section 4(c)(8) that have close operational or functional similarities to bank activities.[12] Indeed, in *National Courier*, 516 F.2d at 1237, the D.C. Circuit described three different types of close functional relationships to banking that the court considered to be within the legislative intent of Section 4(c)(8); the second of these—"[b]anks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service" —is an apt description of the relationship between banking generally and Schwab's discount brokerage securities activities.

In *National Courier*, the court upheld a determination that the provision of high speed transportation or courier services for "audit and accounting media of a banking or financial nature and other business records and documents used in processing such media" is "closely related to banking" and rejected precisely the kind of "facilitation" test petitioner urges here (516 F.2d at 1239):

> We do not think [the Board] has exceeded [its] discretion * * *. Authorization to provide courier services to banks and bank affiliates must carry

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that analysis is based on petitioner's characterization of the activity involved as "providing investment advice," which concededly had been done by banks for years. But *ICI II* involved creating and managing a closed-end investment company, which this Court held was permissible because it was operationally similar to giving investment advice.

[12] See *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (1976), modified on other grounds, 558 F.2d 729 (5th Cir. 1977), cert. denied, 435 U.S. 904 (1978); *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237.

with it the authorization to provide the same services generally.

The court reasoned that to restrict a bank holding company courier service to dealing only with banks or their customers would be inconsistent with the Act's basic purpose to increase competition and eliminate tie-ins between bank and nonbank services. See *ibid.*[18]

Contrary to petitioner's claims (Pet. Br. 16-17), the opinion of the Fifth Circuit in *Alabama Ass'n of Insurance Agents* v. *Board of Governors, supra*, also supports the use of a "close functional relationship" test as the appropriate legal standard. Indeed, the Fifth Circuit quoted approvingly the *National Courier* criteria applied by the Board and the court below in this case, stating "[w]e do not seek to be restrictive in determining what *types* of relationships to banking are cognizable under [§ 4(c)(8)]." 533 F.2d at 240-241 (emphasis added). Far from disapproving reliance on close functional similarities between traditional banking functions and nonbank activities proposed under Section 4(c)(8), the Fifth Circuit observed that there was "no evidence" that banks had provided

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[18] The *National Courier* court did set aside an interpretative ruling of the Board that would have authorized bank holding company-affiliated couriers to provide general courier service for non-financially related materials. Its reasoning was not, as petitioner implies (Pet. Br. 18), based on the necessity for a finding of a "direct and significant" connection between the authorized services and specific banking operations, but rather, the absence from the Board's ruling of any reasonably articulated close relation between the services authorized by the interpretative ruling and banking. See 516 F.2d at 1239-1240.

The court stated that Section 4(c)(8) requires the Board to "articulate the ways in which banking activities and the proposed activities are assertedly connected, and [to] determine, not arbitrarily or capriciously, that the connections are close." 516 F.2d at 1237. It is this test the D.C. Circuit applied in holding that the Board's authorization of general nonfinancial courier services exceeded the Board's authority under Section 4(c)(8). See 516 F.2d at 1241.

services functionally related to the general insurance brokerage service at issue in that case (533 F.2d at 241).[14]

C. The Board Has Consistently Interpreted Section 4(c)(8) As Permitting It To Consider Close Functional Similarities In Deciding Whether Banking And A Proposed Nonbanking Activity Are Closely Related

Since the 1970 amendments the Board has abandoned the requirement (previously implied under the "business of banking" test, see page 19, *supra*) that bank holding companies must demonstrate a direct and significant connection between proposed nonbanking activities and the operations of the banks owned by the applicant bank holding company. The Board has designated as permissible nonbanking activities having close operational and functional similarities to traditional activities of banks in general (relying in particular on the functional tests enunciated in *National Courier*) and has not required a showing that a particular activity has some direct, operational link to the actual business operations of specific banks.[15] Indeed, virtually all of the activities designated

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[14] The court of appeals in *Alabama Ass'n of Insurance Agents* considered (and with respect to certain activities found) other types of close relationships between banking and insurance activities authorized by the regulations under review in that case. On rehearing, the Fifth Circuit expressly noted its adoption of the "tests for closely-related-to-banking set out in *National Courier*." *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 558 F.2d at 730.

[15] Compare, *e.g.*, *United Virginia Bankshares, Inc.*, 56 Fed. Res. Bull. 599, 601 (1970); *Dacotah Bank Holding Co.*, 56 Fed. Res. Bull. 469, 475 (1970); *In re Otto Bremer Co.*, 55 Fed. Res. Bull. 388, 391 (1969); *First Bank Stock Corp.*, 45 Fed. Res. Bull. 917, 930 (1959) (applying "direct and significant connection" test) with, *e.g.*, *BankAmerica Corp.*, 68 Fed. Res. Bull. 647, 648 (1982); *Orbanco Financial Services Corp.*, 68 Fed. Res. Bull. 198, 199

by the Board as permissible under Section 4(c)(8), such as mortgage and consumer lending and providing trust services and investment advice (Regulation Y, 49 Fed. Reg. 794, 826-828 (1984), to be codified at 12 C.F.R. 225.25)), could not be conducted practically by a bank holding company if those services could only be offered to banks or to customers having some identifiable connection with a bank.[16]

In its administration of the Act, the Board has found the standards it applied in this case fully adequate to implement Congress's intent that the Board prevent bank holding companies from entering into commercial areas that lacked a strong nexus to banking. See, *e.g.*, *BankAmerica Corporation*, 66 Fed. Res. Bull. 660, 661 (1980) (underwriting home loan life insurance); *NCNB Corp.*, 64 Fed. Res. Bull. 506, 507 (1978), aff'd, *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609 (4th Cir. 1979) (underwriting credit-related property and casualty insurance and insurance claims adjustment); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549 (7th Cir. 1978) (travel agency); *First Commerce Corp.*, 58 Fed. Res. Bull. 674 (1972) (management consulting). These decisions disapproving various proposed nonbanking activities provide a complete answer to petitioner's asser-

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(1982); *JCT Trust Co.*, 67 Fed. Res. Bull. 635, 636 (1981) (applying "close functional similarity" test).

[16] Also without legal support is petitioner's novel suggestion (Pet. Br. 15) that a nonbank activity otherwise permissible under Section 4(c)(8) becomes impermissible under that section when it is "aggressively marketed to the public in general as an independent nonbank undertaking." To the contrary, the language and legislative history of that section reflect a congressional determination to encourage competition and innovation in nonbank businesses that are closely related to banking. See Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 103(4), 84 Stat. 1764-1765 ("benefits to the public, such as * * * increased competition"); 116 Cong. Rec. 42429 (1970) (remarks of Sen. Goodell); *id.* at 41957 (1970) (letter from Richard Kleindienst).

tion (Pet. Br. 18-19) that the test applied by the Board could flout Congress's intent by permitting bank affiliates to enter into such activities as the retail sales business since banks have used toasters as incentives to attract depositors in the past.

In sum, Section 4(c)(8) of the Bank Holding Company Act confers broad discretion upon the Federal Reserve Board to determine what types of relationships to banking will satisfy the "closely related to banking" test of that statute. Given the breadth of that discretion, the Board's consistent reference in this and other cases to the broad standards articulated in *National Courier* is certainly reasonable. The second *National Courier* standard, applied by the Board, the parties and the court below in this case, is a concise and intelligible articulation of a type of close relationship between kindred bank and nonbank services; it is consistent with the "plain language of the statute," and is certainly narrower than the "functionally related" test considered but not enacted in 1970. Along with the other two *National Courier* standards, this test has been uniformly and consistently quoted both by the courts of appeals and by the Board as an example of the type of relationship to banking that may satisfy the "closely related" requirement in Section 4(c)(8). Congress, having been informed of the Board's use of the *National Courier* standards,[17] has revisited Section 4(c)(8) without changing the closely related language[18] and, moreover, has rejected requests by petitioner and others to modify that

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[17] See *Competition in Banking Act of 1980: Hearings on S. 39, S. 38 and H.R. 2255 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 96th Cong., 2d Sess. 3, 4 & n.1 (1980) (testimony of J. Charles Partee) (*National Courier* standards "have come to be recognized as appropriate for determining whether a nonbanking activity is closely related to banking within the meaning of Section 4(c)(8)").

[18] See Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Tit. VI, § 601, 96 Stat. 1536.

language.[19] It was accordingly entirely proper for the Board and the court of appeals to refer to those standards and apply them in determining that Schwab's discount brokerage services are "closely related to banking."

D. The Board Properly Exercised Its Discretion Under Section 4(c)(8) In Finding That Discount Securities Brokerage Is Closely Related To Traditional Bank Services

In light of the Board's special expertise and responsibility in regulating the commercial banking system, its determinations under the "closely related" test of Section 4(c)(8) should be accorded the "greatest deference" by the courts (*ICI II*, 450 U.S. at 56). The decision of the Board in this case is clearly deserving of that respect.

The Board acted reasonably in finding that the business of executing orders to buy and sell securities solely as the agent of customers is "closely related to banking" for purposes of Section 4(c)(8) (J.A. 129a-132a). Banks have traditionally performed this function for customers in a variety of contexts.[20] Indeed, Section 16 of the Glass-Steagall Act expressly authorizes banks to purchase and sell securities and stock for the account of customers. See *Investment Company Institute* v. *Camp* (*ICI I*), 401 U.S. 617, 624-625 (1970). ("No provision of

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[19] See *Bank Holding Company Legislation and Related Issues: Hearings on H.R. 2255, H.R. 2747, H.R. 2856, et al. Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance, and Urban Affairs*, 96th Cong., 1st Sess., Pt. 2, at 902, 904, 915 (1979) (testimony of John F. Donohue, Jr., on behalf of Securities Industry Association); cf. H.R. 2747, 96th Cong., 1st Sess. 3(a) (1979) ("so closely *and directly* related to banking * * * as to be a proper *and necessary* incident thereto" (emphasis added)).

[20] See generally SEC, *Final Report on Bank Securities Activities* (*SEC Final Report* (1977)); *Initial Report on Bank Securities Activities* (*SEC Initial Report* (1977)), *reprinted in Reports on Banks Securities Activities of the Securities and Exchange Commission*, Senate Comm. on Banking, Housing, and Urban Affairs, 95th Cong. 1st Sess. 1, 289 (Comm. Print 1977); *Brokerage and Related Com-*

the banking laws suggests that it is improper for a national bank * * * to purchase stock for the account of customers.")[21]

For many years, both before and after enactment of Glass-Steagall, many banks bought and sold all types of securities as agent of their customers, usually on an informal basis.[22] See pages 43-45, *infra*. In addition, as the Court recognized in *ICI II*, "[a]s executor, trustee, or managing agent of funds committed to its custody, a bank regularly buys and sells securities for its customers." 450 U.S. at 55.

The SEC's study of bank securities activities found (*SEC Final Report*, *supra*, at 121) that:

> [w]ith respect to the purchase and sale of securities for their managed accounts, bank trust departments are performing in many respects the same activities as are performed by retail brokerage firms. They are effecting transactions in securities for the account of others.[[23]]

Unlike retail discount brokers such as Schwab, which execute orders to buy and sell securities directly, banks

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mercial Bank Services: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 2d Sess. (1976); H.R. Rep. 94-1193, 94th Cong., 2d Sess. 7 (1976).

[21] Since, as demonstrated below, this provision authorizes banks to provide retail brokerage services it necessarily follows that such services are "closely related to banking."

[22] Beginning as early as 1953, commercial banks offered a number of specialized services that enabled third parties to invest predetermined amounts of money in securities issued by an employer (Employee Stock Purchase Plans), in additional shares of securities already held by the third party (Dividend Reinvestment Plans), or in specific securities designated by the bank (Automated Investment Services). *SEC Initial Report*, *supra*, at 13, 15, 36-37, 54-59.

[23] Bank trust departments constitute some of the largest institutional investors in the securities markets and account for a significant percentage of daily trading volume. See *SEC Final Report*, *supra*, at 163-164.

traditionally have used brokers to execute trades, largely because incorporated commercial banks have historically been excluded from membership in securities exchanges. But banks often execute orders directly without the use of intervening brokers for securities not listed on an exchange, dealing directly with dealers making a market in the securities or with other institutions. See *SEC Final Report*, *supra*, at 122, 166-169. Moreover, where bank trading desks employ brokers to execute orders for securities, the banks exercise considerable discretion and expertise in selecting particular brokers to execute orders, making the same types of decisions, and utilizing the same types of facilities and personnel with the same training and expertise as brokers do in the actual execution of these orders. See *SEC Final Report*, *supra*, at 165-179.

Based on this evidence, the Board found that banks generally, by virtue of their extensive securities transactions experience, are particularly well-equipped to perform the "operationally and functionally very similar" brokerage services offered by Schwab (J.A. 129a, 131a). Accordingly, the Board's findings provide ample support for its conclusion that Schwab's brokerage activities are "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company. Compare *ICI II*, 450 U.S. at 56-58; *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d at 241; *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237.

II. THE GLASS-STEAGALL ACT DOES NOT PROHIBIT A BANK HOLDING COMPANY FROM ACQUIRING A DISCOUNT BROKERAGE COMPANY THAT EXECUTES SECURITIES TRANSACTIONS AS AGENT, UPON THE ORDER AND FOR THE ACCOUNT OF, RETAIL CUSTOMERS

In its order, the Board found that the acquisition by a bank holding company of a discount securities brokerage firm is consistent with the provisions of the Glass-Steagall Act that insulate commercial banking from investment banking (J.A. 147a-154a). The Board concluded that as a discount broker Schwab is not "en-

gaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the prohibition of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which applies to affiliates of member banks of the Federal Reserve System (J.A. 147a-151a). Further, the Board found that the acquisition is not inconsistent with the purposes of the Glass-Steagall Act, since Schwab does not deal in securities with its own assets and does not have a promotional interest or a salesman's stake in the sale of any particular issue of securities (J.A. 147a-151a). The Board's interpretation is consistent with the plain meaning and intent of Section 20, as interpreted previously by this Court, and therefore should be upheld.

A. Discount Brokerage Is Not Among The Securities Activities Proscribed To Bank Affiliates By Section 20 Of The Glass-Steagall Act

1. It is axiomatic that "in determining the scope of a statute, one is to look first at its language." *North Dakota* v. *United States*, No. 81-773 (Mar. 7, 1983), slip op. 12; and cases cited therein. Section 20 of the Glass-Steagall Act provides (12 U.S.C. 377):

> [N]o member bank shall be affiliated * * * with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities.

Because it applies by its terms to affiliates of member banks, Section 20 is the most obviously relevant provision of the Act governing the permissible securities activities of bank holding companies and their nonbank subsidiaries. 450 U.S. at 50-59 n.24, 60-61 n.26.[24]

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[24] Since "affiliate" is defined in 12 U.S.C. 221a(b)(2) to include a corporation under common control with a member bank, Schwab would become "affiliated" with Bank of America, a member bank, within the meaning of Section 20 as a result of Schwab's acquisition by BankAmerica.

Schwab is engaged principally in buying and selling securities as agent or broker for its customers and, not to any material extent, for its own account (J.A. 127a).[25] It is undisputed that Schwab's securities brokerage activities do not constitute the "issue, flotation, underwriting * * * or distribution" of securities for purposes of Section 20. The only term in the list of prohibited activities that could possibly apply to Schwab's practices is the "public sale" of securities. But it is clear that public sale as used in Section 20 does not embrace mere brokerage activities as an agent.

In describing the securities activities bank affiliates are prohibited from performing, Section 20 makes no mention of "brokerage," the term generally employed to describe securities transaction services performed by an agent for a customer.[26] Moreover, since discount brokerage necessarily involves both the purchase and sale of securities for customers, the term "public sale" does not accurately describe that activity.

The specific context in which the term "public sale" appears in Section 20 conclusively establishes that the term is meant to refer to activities involving the existence of a salesman's stake or a promotional interest in the sale of particular securities. "Public sale" is used in conjunction with "issue," "flotation," "underwriting," and "distribution"—terms that everyone in the securities industry understands to refer to operations involving the marketing of new issues or the introduction of blocks of

[25] Schwab acts as principal only on very infrequent occasions, when, for example, it purchases securities for a customer by mistake. Even if such transactions are of the type described in Section 20, they comprise only a miniscule part of Schwab's activities and are not an activity in which Schwab is "engaged principally" (J.A. 39a-40a, 72a). Petitioner does not base its analysis of Section 20 on this point.

[26] 2 L. Loss, *Securities Regulation* 1215 (2d ed. 1961) (a broker executes an order for securities as agent of his customer; a dealer in securities acts for his own account and not as agent for the customer).

particular securities to the public generally. Moreover, the term "public sale" is similar to the term "public offering," which conventionally refers to the promotion and distribution to the public of a new issue or large block of securities by an issuer or underwriter, usually with a securities firm acting not as agent but as principal.[27] "It is a familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third National Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977).[28] This canon of statutory construction is particularly apt where, as here, it is undisputed that four of the five terms refer generally to the same activity; it defies common sense to assume that the fifth term was intended to have a radically different meaning. In sum, the text of Section 20 is completely contrary to petitioner's contention that the activities restricted by that section include securities brokerage services performed as agent. On the basis of the plain meaning of Section 20, by itself, the decision below should be affirmed.

2. A further indication of the meaning intended for the term "public sale" in Section 20 is the fact that the brokerage activities of banks and bank affiliates received virtually no attention during congressional consideration of the Act. Since the draftsmen of the legislation detailed those securities functions undertaken by banking organizations that were perceived by Congress to have been the cause of bank failures in the

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[27] See 1 L. Loss, *supra*, at 551; see generally *id.* at 159-172, 547-555.

[28] Even if, as petitioner asserts (Pet. Br. 38), the terms used in conjunction with "public sale" in Section 20 may include some promotional activities that are not conducted as a principal, all of these statutory terms connote the public promotion of particular issues of securities in which the promoter has a salesman's stake. The execution of transactions in securities upon the order of customers does not involve any such activity. Moreover, although as a remedial statute, the Act should be construed so as to effectuate its purposes, correct construction of its terms still must "rel[y] squarely on the literal language." *ICI II*, 450 U.S. at 65.

1930's, the absence of any mention of brokerage functions is significant. In 1933, Congress was concerned about banks acting for their own accounts—the "overinvestment [by banks] in securities of all kinds" which led to "the funds of various institutions [being] so extensively 'tied up' in long-term investments." [29]

Representative Bacon described concisely the activities of banks during the late 1920's and early 1930's that had caused the bank failures and were therefore the focus of Congress's prohibitions in Glass-Steagall. In referring to bank affiliates, he explained (77 Cong. Rec. 3954 (1933)):

> [T]heir needs for more merchandise led them to participate in, underwrite, or originate a growing proportion of [securities]. The more they sold, the more new issues they sought to handle. And as this growth continued, the more bank credit they were forced to make available for the purchase of new securities.
>
> * * * * *
>
> In the era of high-pressure investment sales many unsound issues were offered and many found their way into the portfolios of the smaller banks in the agricultural States.

Because banks and their affiliates had acted in concert to manipulate the market through these underwriting activities, Congress passed the provisions of Glass-Steagall to "keep commercial banks out of the investment business and commercial credit out of speculative channels." 77 Cong. Rec. 3954 (1933) (remarks of Rep. Bacon). Mere brokerage activities of nonbanking affiliates were obviously not the focus of congressional concern in 1933.[30]

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[29] S. Rep. 77, 73d Cong., 1st Sess. 8 (1933).

[30] S. Rep. 77, *supra*, at 10. Accord, *Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess., Pt. 7, at 1057-1063 app. (1931).

Furthermore, permitting bank holding companies to offer discount brokerage services through an affiliate will not produce the unsound banking practices and conflicts of interest that the Act was intended to avoid. There is no danger that the funds of BankAmerica's depositors will be invested in imprudent securities investments, *ICI*, 401 U.S. at 630, *ICI II*, 450 U.S. at 66, because Schwab buys and sells securities only as agent, not as principal. Likewise, since Schwab has no interest in the purchase or sale of any particular securities—its income depends solely on the volume of securities traded—there is no realistic likelihood that the Bank of America would make unsound loans to issuers in order to help market the issuers' securities or to investors to help them purchase specific securities. See *ICI I*, 401 U.S. at 631; *ICI II*, 450 U.S. at 66-67 n.38. In addition, although an affiliate's unsuccessful operation may damage public confidence in a bank, since Schwab has no promotional stake in any particular securities, the loss of customer goodwill or damage to Bank of America's reputation would be no different than if any other affiliate lawfully owned by BankAmerica or some other holding company failed. See *ICI I*, 401 U.S. at 631-632; *ICI II*, 450 U.S. at 66 n.38. Finally, mere brokerage activities do not create serious conflicts of interest. Schwab's personnel provide only one service—execution of securities trades as agent of their customers; Schwab lacks a "salesman's stake in a particular investment." 401 U.S. at 638. In sum, brokering securities simply does not create the kinds of hazards against which Congress intended Section 20 of the Glass-Steagall Act to guard.[31]

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[31] Petitioner's reliance (Pet. Br. 21) on passing references to brokerage *houses* in remarks of one congressman and in this Court's *ICI II* opinion is misplaced. Neither reference was made in a discussion of brokerage *activities*, and it was as true in the 1930's as it is today that many securities firms that provide brokerage services also underwrite or deal in securities—operations that

3. Any doubt concerning the Board's conclusion that "public sale" as used in Section 20 does not include brokerage activities can be dispatched on the basis of the Board's longstanding and virtually contemporaneous interpretation of the same language in Section 32, 12 U.S.C. 78, which is a closely related provision of the same Act. Section 32 is specifically addressed to the securities activities of member bank affiliates, and it prohibits individuals from serving in certain capacities for both member banks and business entities that are "primarily engaged in the issue, flotation, underwriting, public sale, or distribution * * * of * * * securities." In January 1936, the Board issued its Regulation R, implementing the provisions of Section 32, which provides (22 Fed. Res. Bull. 51 n.1, codified at 12 C.F.R. 218.1 n.1):

> A broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32.[32]

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clearly are among the activities proscribed by Section 20. See *Board of Governors* v. *Agnew*, 329 U.S. at 445-446; 2 L. Loss, *supra*, at 1215; SEC, *Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker* 87 (1936) ("it might well be said that all commission houses * * * combine the broker and dealer functions"). In any event, Rep. Kopplemann was specifically concerned about the situation in which those responsible for "determin[ing] the type and character of the banks' investments are at the same time promoters and sellers" of securities. 77 Cong. Rec. 3907 (1933) (remarks of Rep. Kopplemann). A broker, such as Schwab, has neither a promoter's nor a salesman's interest in the sale of any particular issue of securities.

[32] As originally enacted in 1933, Section 32 prohibited interlocks between a member bank and a firm primarily engaged in the business of "purchasing, selling, or negotiating securities." 48 Stat. 194. In an opinion published in June 1934, the Board stated that the terms purchase and sale as used in that provision connote the passing of ownership to or from the persons making the purchases or sales and thus that an organization engaged solely in executing orders for the purchase and sale of securities on behalf of others "is not within the intent or language of the statute." 20 Fed. Res. Bull. 393. The Banking Act of 1935, ch. 614, § 307, 49 Stat. 709, revised Section 32 to its present form in order to conform the

The Board has never modified this interpretation of Section 32.[33] Since Sections 32 and 20 employ identical language, were enacted for the same purpose and as parts of the same statute, and, indeed, even deal with

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description of the securities activities covered in that section to other provisions of the Glass-Steagall Act. H.R. Rep. 742, 74th Cong., 1st Sess. 17 (1935). Contrary to petitioner's assertion (Pet. Br. 40 n.72), the Board's construction of Section 32 was brought to the attention of Congress prior to the 1935 amendment. 1934 Federal Reserve Board Ann. Rep. 58 (Board interpreted the original Section 32 as covering only "the underwriting and distribution of securities").

[33] In reliance on the Board's interpretation of Section 32, a number of well-known figures in securities brokerage firms served as directors of large member banks of the Federal Reserve System immediately following enactment of the Glass-Steagall Act and thereafter. Prior to Glass-Steagall, several members of private banking firms, such as J.P. Morgan & Co. and Brown Brothers Harriman & Co. were both commercial and investment bankers and served as directors of member banks in New York City. To comply with the Act, the firms divested their securities underwriting and dealing activities. They continued commercial banking and continued to conduct a commission brokerage business as members of the New York Stock Exchange and other exchanges. N.Y. Times, June 9, 1934, at 21, col. 3; 138 Com. & Fin. Chron., June 9, 1934, at 3869, col. 1 (1934). Members of these firms also continued to serve as directors of member banks. See, *e.g.*, 26 Am. Bankers Ass'n J. 12 (1934) (statement of Guaranty Trust Co. listing among its directors Thomas Lamont and George Whitney of J.P. Morgan & Co. and W.A. Harriman of Brown Brothers Harriman & Co.); *id.* at 45 (statement of New York Trust Co. listing among its trustees two Morgan partners and a Brown Brothers Harriman partner). That such open and public relationships between banks and firms engaged in the brokerage business continued after the enactment of Section 32 without comment or objection from anyone forcefully demonstrates that "public sale" as used in Section 32 was not intended to reach the business of a commission broker, especially since these interlocking relationships involved firms, such as J.P. Morgan, that had been a chief target of the Glass-Steagall Act. See *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 56 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess., Pts. 1-2 (1933); 77 Cong. Rec. 3730 (1933) (remarks of Sen. Glass).

the same subject matter, the Board's longstanding interpretation that "public sale" in Section 32 excludes brokerage activities applies with equal force to the same term in Section 20. See *Northcross* v. *Board of Education*, 412 U.S. 427, 428 (1973); *Hargrave* v. *OKI Nursery, Inc.*, 646 F.2d 716, 720 (2d Cir. 1980).

Given the Board's expertise in reviewing the activities of holding companies and banks[34] and its longstanding and virtually contemporaneous determination that securities brokerage is not among the activities described in Sections 20 and 32 of the Act, "considerable respect is due [its] 'interpretation.'" *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980). See also *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 31-32, 37-39 (1981); *Power Reactor Development Co.*

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[34] The Board, through the Federal Reserve Banks, examines, supervises and enforces applicable laws with respect to state-chartered member banks as well as bank holding companies. 12 U.S. 325, 504, 505, 1818(b) and (e), 1844, 1847. The Federal Reserve System also takes action to control the growth of reserves held by depository institutions, 12 U.S.C. 263, 461, and extends funds to member banks and other depository institutions, 12 U.S.C. 343, 352, 357, 461(b)(7).

In *ICI II*, this Court quoted with approval Justice Rutledge's description of the deference that is due the Board's construction of the Glass-Steagall Act in view of its "specialized experience" (450 U.S. at 56-57 n.21, quoting *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. at 450 (concurring opinion)):

> Not only because Congress has committed the system's operation to [the Board of Governors'] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, I think their judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have, not only in dealing with the problems raised for their discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer it. Accordingly their judgment in such matters should be overturned only where there is no reasonable basis to sustain it or where they exercise it in a manner which clearly exceeds their statutory authority.

v. *Int'l Union of Electrical, Radio and Machine Workers*, 367 U.S. 396, 408 (1961).[35]

The Board's conclusion that brokerage functions are not part of underwriting or the "public sale" of securities within the meaning of the Glass-Steagall Act has already been implicitly accepted by this Court in *Board of Governors* v. *Agnew*, *supra*. In *Agnew*, a divided court of appeals held that a securities firm (Eastman Dillon) engaged in underwriting and brokerage activities was not "primarily engaged" in any of the activities described in Section 32, because its brokerage activities, as opposed to its *underwriting* activities, constituted its most significant source of revenue. *Agnew* v. *Board of Governors*, 153 F.2d 785, 791 (D.C. Cir. 1946). In the court of appeals' opinion, both the majority and the dissent used the term "underwriting" to refer to all of the securities operations described in Section 32 and considered brokerage to be outside the activities described by that section (153 F.2d at 787, 795). Indeed, the majority noted that "[u]nderwriting and brokerage, although both concerned with securities, are vastly different operations" (*id.* at 790).

Reversing the court of appeals, this Court held that Eastman Dillon's underwriting activities were substantial enough to support the Board's conclusion that the firm was "primarily engaged" in activities described in Section 32. But in so holding, the Court started from the same premise as the court of appeals—that Eastman Dillon's brokerage activities were not within the scope of Section 32. 329 U.S. at 445 & n.3, 446. Indeed, when the Court described Section 32's scope it repeatedly characterized it as concerning "underwriting" (329 U.S. at

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[35] Deference to the Board's construction of the Glass-Steagall Act is also appropriate in this case because the Board has been vested by Congress with responsibility for enforcing the relevant statutory provisions. Section 20 authorizes the Board to assess civil money penalties for violations of its terms. Section 32 authorizes the Board to provide by regulation for exceptions to the management interlocks prohibition in that Section.

447, 448, 449). Had this Court believed, as petitioner now asserts, that Section 32 embraced an investment firm's brokerage activities, it would have been wholly unnecessary for it to decide the meaning of "primarily" in Section 32, because no one disputed that the largest part of the firm's revenue was derived from securities brokerage activities.

B. Section 20 Contains The Only Prohibition In The Glass-Steagall Act That Is Relevant To BankAmerica's Acquisition, As A Bank Holding Company, Of Schwab

Petitioner in its brief devotes almost no attention directly to Section 20 of the Glass-Steagall Act, virtually conceding that Section 20 read by itself does not prohibit BankAmerica's acquisition as a bank holding company of Schwab. Petitioner attempts (Pet. Br. 20-34), however, to shift the Court's attention to Section 16 of the Glass-Steagall Act, which by its terms only applies to *national banks* and permits them to engage in "purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers." 12 U.S.C. 24 Seventh.[36] Finding in this provision language that bears at least some slight resemblance to the services rendered by Schwab, petitioner asks the Court to decide this case without regard to Section 20's language, purpose and prior administrative interpretation.

We submit that Congress intended Section 20 to be the sole limitation on the activities of BankAmerica and that the distinct requirements of Section 16 are irrelevant to this case.[37] As this Court pointed out just this Term,

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[36] Although by its terms Section 16 applies only to national banks, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, provides that state member banks of the Federal Reserve System are subject to the same limitations and conditions that Section 16 imposes on national banks "with respect to the purchasing, selling, underwriting, and holding of investment securities and stock."

[37] Nor is there any basis for interpreting the language of Section 20 in light of Section 21(a) of the Glass-Steagall Act, 12 U.S.C. 378(a), which prohibits an organization "engaged in the business of issuing, underwriting, selling, or distributing," inter alia, secu-

"[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello* v. *United States*, No. 82-472 (Nov. 1, 1983), slip op. 6-7 (quoting, *United States* v. *Wong Kim Bo*, 472 F.2d 720, 772 (5th Cir. 1972)). See *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 521 (1982); *United States* v. *Naftalin*, 441 U.S. 768, 773-774 (1979).[38]

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rities "to engage at the same time to any extent whatever in the business of receiving deposits." Neither BankAmerica nor Schwab receives deposits. Moreover, contrary to petitioner's assertion (Pet. Br. 35), the term "selling" in Section 21 does not mean brokerage activities; the Board interpreted that same term in the original Section 32 to exclude brokerage. See note 32, *supra*. Finally, it is quite clear that the reference to purchasing and selling investment securities in the proviso to Section 21 was intended to grant all depository institutions the authority to purchase and sell United States and municipal obligations, and thus the proviso provides no support for petitioner's claim regarding how Section 16 or Section 20 should be interpreted. See H.R. 742, 74th Cong., 1st Sess. 16 (1935); *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 662 (1935); *Banking Act of 1935: Hearings on H.R. 1715 and H.R. 7617 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 74th Cong., 1st Sess. 139 (1935).

[38] Moreover, petitioner's attempt to read Section 16 into Section 20 leads to unreasonable results that Congress could not possibly have intended. Section 20 uses the term "public sale" in a list of prohibited investment banking functions; the permission in Section 16 to purchase and sell securities for the account of customers is a separate authorization that is independent of that Section's general prohibition against dealing in and underwriting securities. Thus, if "public sale" in Section 20 is construed to encompass the purchase and sale of securities on behalf of customers, bank holding companies would be prohibited from offering *any* brokerage services (even the limited services petitioner concedes are permissible under Section 16 for banks) as a principal line of business. Moreover, this quandary cannot be escaped by reading into Section 20 petitioner's proposed limited authorization for brokerage services for preexisting banking customers, because affiliates of banks have no preexisting customers of banking services and are not limited to offering services to customers of their affiliated banks.

Petitioner's response (Pet. Br. 37) to this plain reading of the two provisions is that nothing in the legislative history indicates clearly that Congress intended for Section 20 to have a reach different from Section 16. But the language Congress used in the two provisions unmistakably indicates that they are not coterminous. The burden is therefore petitioner's to demonstrate that, notwithstanding their obvious differences, the provisions nevertheless should be read in identical fashion. Petitioner cannot satisfy that burden by citing (Pet. Br. 37) a single comment by one Senator indicating that the various provisions in the Glass-Steagall Act are "interrelated with a single purpose." 76 Cong. Rec. 1412 (1933) (remarks of Sen. Metcalf). No one disputes that Congress had a single purpose underlying its decision to adopt these provisions; the issue is whether it went about fulfilling that purpose by imposing identical restrictions on banks and bank holding companies.[30]

The language of the statute compels the conclusion that Congress intended Section 20's scope to be different from Section 16's. This Court has recognized as much in *ICI II*, *supra*. Noting that Section 20 authorizes bank affiliates to engage to some extent (less than principally) in securities activities that are flatly prohibited to banks, the Court concluded that the Act's structure therefore "reveals a congressional intent to treat banks separately from their affiliates" and to impose "a less stringent standard" on bank holding companies. *ICI II*, 450 U.S. at 59 n.24, 61 n.26. It is fully consistent with the statute's structure and Section 20's less stringent standard

[30] If Senator Metcalf's remarks were sufficient to require the various provisions of Glass-Steagall to be read identically, then the use in Section 20 of the phrase "engaged *principally*" in underwriting activities would also have to be read out of the statute since no similar limitation appears in either Section 16 or 21. In *Agnew*, this Court concluded that the different qualifying phrases used in the various Glass-Steagall provisions were intended to "mark[] a distinction we should not obliterate" (329 U.S. at 448).

that bank holding companies be permitted to engage in a somewhat wider range of activities than are banks.[40]

C. Section 16 Of The Glass-Steagall Act Authorizes National Banks To Provide Discount Brokerage Services

The result is no different in this case even if we are incorrect that the plain meaning of Sections 16 and 20 necessarily establishes that they cover somewhat different activities and that Section 20's restriction on underwriting securities is the only prohibition relevant to a bank holding company. BankAmerica's proposed discount brokerage activities are authorized by Section 16's grant of power to a national bank "to purchas[e] and sell[] such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account." 12 U.S.C. 24 Seventh. Under an ordinary reading of Section 16, Schwab's brokerage activities are fully consistent with this authorization; Schwab acts solely as agent for its customers, based on their orders and solely for their accounts—not for Schwab's account—and the transactions are executed without recourse, since Schwab assumes no liability as maker, endorser or guarantor of the value or price of the security being bought or sold. Indeed, the Comptroller of the Currency, who has responsibility for administering Section 16's requirements for national banks, takes the view that national banks may offer discount brokerage services to the public. See *New Bank National Subsid-*

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[40] The creation of a slightly less stringent standard for bank holding companies fully comports with the basic purpose of the Act to safeguard the depositors of banks because "[b]ank holding companies do not receive deposits." *ICI II*, 450 U.S. at 58 n.24. Moreover, the ability of banks in a holding company system to use depositors' funds in order to fund the operations of nonbank affiliates is severely curtailed by the restrictions of Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, as added by the Glass-Steagall Act. The fact that Section 20 prohibits affiliates from engaging, as a principal line of business, in the kinds of securities functions that Congress believed to be too risky for banks to conduct at all still effectuates the purposes of the Act by eliminating the realistic danger that losses of an affiliate may seriously damage a bank.

iary Allowed to Offer Discount Brokerage Services, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 82-256 (Aug. 26, 1982), aff'd *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), appeal docketed, Nos. 84-5026 and 84-5085 (D.C. Cir. Jan. 13 and Feb. 9, 1984).

1. Petitioner primarily argues (Pet. Br. 21-31) that the authorization to execute transactions "for the account of customers" implies a requirement that the individual using the brokerage service must previously have used other services offered by the bank. While this reading of the statute is consistent with limitations once imposed on brokerage services of national banks by the Comptroller of the Currency (see 1 Bulletin of the Comptroller of the Currency 2 (1936)), it is not supported by the language or legislative history of Section 16. Congress used the term "customers" in Section 16 merely to clarify the succeeding prohibition against a national bank's dealing in stock or other securities "for its own account," and to explain the preceding limitation, "solely upon the order, and for the account of," which would be unintelligible without the term "customers." 12 U.S.C. 24 Seventh. This interpretation is in accord with the basic purpose of that provision, which is to draw a bright-line distinction between impermissible transactions by a bank as a principal and permissible transactions by the bank as agent for others.[41]

In addition, the limited legislative history regarding Section 16 is fully consistent with the Comptroller's interpretation of "customer." The Congressional Reports on the Glass-Steagall Act explain that "national banks are to be permitted to purchase and sell investment securities for their customers *to the same extent as here-*

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[41] Section 16 thus generally bars a bank from dealing in securities "for its own account" and limits a bank's purchase of securities "for its own account" to investment securities as defined in the statute, subject to certain limitations based on the bank's capital. The statute also excepts from this limitation purchases by a bank "for its own account" of certain types of government securities. 12 U.S.C. 24 Seventh.

tofore." S. Rep. 77, 73d Cong., 1st Sess. 16 (1933); H.R. Rep. 150, 73d Cong., 1st Sess. 3 (1933) (emphasis added). Prior to 1933, both national and state banks regularly bought and sold securities in an agency capacity. See *Blakey* v. *Brinson*, 286 U.S. 254 (1932); *McNair* v. *Davis*, 68 F.2d 935 (5th Cir.), cert. denied, 292 U.S. 647 (1934); *Mark* v. *Westlin*, 48 F.2d 609 (D. Minn. 1931); *Dyer* v. *Broadway Central Bank*, 252 N.Y. 430, 169 N.E. 635 (1930); *Block* v. *Pennsylvania Exchange Bank*, 253 N.Y. 227, 170 N.E. 900 (1930); *Le Marchant* v. *Moore*, 150 N.Y. 209, 44 N.E. 770 (1896); *Central National Bank* v. *White*, 139 N.Y. 631, 34 N.E. 1065 (1893); see also W.N. Peach, *The Security Affiliates of National Banks* 72-75 (1941); *Banks Allowed to Continue Stock Service*, The Bankers Magazine 699 (June 1934); [1924] Comp. of the Currency Ann. Rep. 12; R. Westerfield, *Banking Principles and Practice* 713-719; 1021-1039 (1921). Banks offering brokerage services did not require customers seeking to use such services to make a special deposit or draw a check to cover the purchase price. See *Blakey* v. *Brinson*, 286 U.S. at 259; *McNair* v. *Davis*, 68 F.2d at 936. Moreover, prior to 1933, banks provided brokerage services to the public generally, not just to individuals who enjoyed a preexisting customer relationship with the bank. See *Greenfield* v. *Clarence Sav. Bank.*, 5 S.W.2d 708 (Mo. Ct. App. 1928) (customer, not regular depositor, left $2,000 with bank solely for the purpose of purchasing bonds through the bank). See also, A. Smith, *Stock Market Service Comes High*, 21 Am. Bankers Ass'n J. 965 (Apr. 1, 1929) (observing that banks frequently "buy and sell securities for * * * customers and the public in general").[43]

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[43] Although national banks, like other corporations, were excluded from membership in the stock exchanges at that time, various private bankers were members of the New York Stock Exchange when the Glass-Steagall Act was passed. Several announced that they were continuing their commission brokerage business after the Act's implementation date. See N.Y. Times, June 9, 1934, at 21, col. 3; 138 Com. & Fin. Chron., June 9, 1934, at 3869,

In light of the existing banking practices, it seems doubtful that Congress intended its reference to "customers" in Section 16 to serve as an insuperable obstacle to a bank performing brokerage services for someone who had not used the bank previously so long as the bank's brokerage services were performed strictly as agent and not for the bank's account. Certainly in rural areas in the 1930's, access to stock exchanges was limited and small town banks could and did perform an invaluable service by placing securities orders for people who lived away from commercial centers. See *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935) (testimony of the Comptroller of Currency).

Moreover, limiting bank brokerage services to prior users of other services offered by the bank does not further any of the purposes of the Act. Petitioner's interpretation of customer does not preclude the provision of brokerage services altogether; it merely limits the extent to which the bank's services would be marketed. If it is not an unsound banking practice or conflict of interest to purchase and sell securities for preexisting customers, it is difficult to perceive how the evils to which the Act was addressed will result when a bank makes a stock transaction as agent for someone who has not rented a safe deposit box from the bank or opened a Christmas Club Account there.

The legislative history petitioner relies upon (Pet. Br. 23-27) does not suggest that Congress understood the term "customer" to mean preexisting customer or that it ever ratified such an interpretation by the Comptroller. The only references cited by petitioner (Pet. Br. 22-24) in connection with Section 16 are the Comptroller's statements made in 1934 and 1935, asking Congress to amend Section 16 to allow banks to act as agent for the purchase and sale of "stock" as well as other types of securities. Petitioner stresses that the Comptroller's state-

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col. 1; 4042, col. 2; 4210, col. 1. At least one private banker has continued to remain a member since then. See [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 86,258 (Aug. 26, 1982).

ments indicate that the bank will act solely "in an accommodation capacity." But that statement gives no clear indication of what he meant; the Comptroller's purpose in proposing the 1935 amendment to Section 16 was to make it easier for "the *public* located in communities removed from the money centers [to] dispos[e] of or purchas[e] securities in the form of corporate stocks for investment purposes." 1933 Comp. of the Currency Ann. Rep. at 11 (1934). It is difficult to perceive how this purpose would be served by the technical notion of accommodation petitioner proposes.[43]

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[43] The Comptroller did not expressly incorporate the idea of an independent customer relationship until his Report in 1936, well after Congress had acted. 1 Bulletin of the Comptroller of the Currency 2 (1936). Even if "accommodation" as used by the Comptroller in his testimony more clearly indicated that he intended that the services must be applied to a preexisting customer, Congress itself did not include "accommodation" as part of the statute. Thus, the discussion by the Comptroller does not indicate what Congress meant by customer in 1933 any more than the Comptroller's later administrative interpretation of the Act, which, as we discuss at pages 47-48, *infra*, is not dispositive on this issue.

Nor do the statements of Thomas F. Corcoran, cited by petitioner (Pet. Br. 25-27), provide any basis for concluding what Congress meant by its reference to "customers" in Section 20 of the Glass-Steagall Act. Mr. Corcoran was the general counsel of the Reconstruction Finance Corporation and one of the draftsmen of the Securities Exchange Act of 1934; he did not participate in drafting the Glass-Steagall Act, nor was he responsible for administering or interpreting that law. Moreover, Mr. Corcoran's brief remarks were merely a description of bank activities in the securities area and did not even purport to be a legal explication of the full powers of banks under Section 16.

Petitioner asserts (Pet. Br. 27) that since no one on the committees expressed disagreement with the statements, they necessarily represent Congress's view. The same committee, however, also listened to Richard Whitney, the President of the New York Stock Exchange, explain that "banks * * * customarily act *as agents* for their customers in buying and selling securities," and no one questioned this statement. *Stock Exchange Regulation: Hearing on H.R. 7852 and 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 154 (1934). As one commentator has noted, in light of the divergent views expressed on the point, "the role that Congress thought banks would play in the securities industry is unclear." Note, *A Banker's Adventures in*

2. Petitioner argues (Pet. Br. 28-31) in favor of its narrow construction of Section 16 that the Comptroller adopted, albeit without explanation, a similarly narrow interpretation in 1936. But this construction may have been based solely on the Comptroller's view of proper policy. The Federal Reserve Board, which is charged with administering Section 16 with respect to state member banks, did not share the Comptroller's view regarding the scope of bank brokerage services under that Section. In ruling on May 15, 1934 that the Glass-Steagall Act did not prohibit state member banks from performing stock brokerage services, the Board made no mention of any requirement of a preexisting customer relationship.[44]

Even assuming that the Comptroller's rule was based on his reading of the statute, petitioner's argument assumes that once an agency has interpreted a statute, that interpretation is frozen for all time, unless Congress enacts new legislation. Administrative law is not so inflexible. An agency "faced with new developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practices." *American*

Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services, 81 Mich. L. Rev. 1498, 1533 n.168 (1983).

Finally, petitioner cites nothing in the Reports or debates indicating that banks were excluded from the definition of broker in the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(4), because of limitations on their activities imposed by Glass-Steagall. The legislative history of the 1934 securities legislation suggests that banks were exempted from the Act's coverage primarily because they were already subject to extensive supervision by federal and state banking authorities. See S. Rep. 792, 73d Cong., 2d Sess. 14 (1934).

[44] See 138 Com. & Fin. Chron., May 19, 1934, at 3364, col. 2. In a later publication of this ruling, the Board noted certain limitations (other than the preexisting customer requirement) placed on national banks' brokerage activities by the Comptroller of the Currency, but did not embrace those limitations in its own ruling with respect to state member banks. See 20 Fed. Res. Bull. 609 (1934).

Trucking Ass'n v. *Atchison, T. & S.F. Ry.*, 387 U.S. 397, 416 (1967). It remains, of course, incumbent upon the agency to provide a reasoned explanation for the change. See *Baltimore & A. R.R.* v. *Washington Metropolitan Area Transit Comm'n*, 642 F.2d 1365, 1370 (D.C. Cir. 1980).

The Comptroller's 1982 ruling was the culmination of previous rulings by the Comptroller and was made in response to the emergence of a new form of brokerage activity made possible by the unfixing of broker's fees.[45] In addition, the Comptroller explained that the earlier interpretations were not supported by any explanation or mandated by any specific language in the statute. In the Comptroller's view, the prior interpretation was overly cautious and completely unnecessary to protect against the hazards that had motivated Congress to enact Section 16, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 86,255 (Aug. 26, 1982). These are clearly adequate bases for overturning his prior rulings and thus the Comptroller's more recent interpretation, which is itself reasonable, is entitled to respect by this Court. Under that interpretation, it is undisputed that Schwab's activities, even if performed by a national

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[45] Actually, the Comptroller's relaxation of the restrictions initially imposed on national banks' brokerage activities began much earlier. As the Comptroller stated in 1974, summarizing the change in agency policy [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272, at 81,358 (June 10, 1974)):

> The office position from 1936 to 1957 was that it was inconsistent with the idea of an "accommodation" service for a bank to make a profit on such service. These old rulings did not reveal the rationale for concluding that a bank service, expressly authorized by Congress, could not be marketed in the usual fashion. This view, like many others expressed by bank regulators, in the immediate post-depression decades, was designed to be ultra-conservative and to confine banks as narrowly as possible in their activities. However, in this regard, the office apparently went further in the direction of conservatism than did the Congress, since neither the word nor the idea of the "accommodation" limitation appears in the statute or in any committee or floor comments.

bank directly, are not prohibited by Section 16. See *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983); *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), vacated as moot, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978).

3. Finally, petitioner argues (Pet. Br. 31-34) that it would violate the "without recourse" restriction in Section 16, if banks were allowed to engage in discount brokerage services. Schwab does not, however, assume any liability as maker, endorser or guarantor of any of the securities it buys or sells for its customers, which is the commonly understood meaning of that term. See G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 994 (8th ed. 1983); 2 R. Anderson, *Uniform Commercial Code* § 3-414:6, at 995 (2d ed. 1971) ("The words 'without recourse' have a fixed meaning; they operate to disclaim the liability of an endorser," *i.e.*, the contingent liability to pay the principal amount of the instrument at maturity.) Petitioner argues (Pet. Br. 31-34) that "without recourse" in this context must mean that the bank cannot incur any liability to anyone in connection with its execution of the purchase or sale of securities by a customer. Since Schwab is liable nominally to third parties if Schwab's customers fail to deliver funds due for purchases of securities they have ordered, petitioner concludes (Pet. Br. 31-34) that the sale is not without recourse. Petitioner asserts that this view is supported by this Court's decision in *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209 (1935).

The contention is completely without merit. In *Awotin*, the bank had agreed to repurchase bonds at a set price, thus providing a clear guaranty to the purchaser. The bank refused to make good the guaranty and the purchaser sued. In response to the argument that the bank's authority to sell bonds was limited by the "without recourse" requirement, the purchaser argued that the technical form of the transaction did not involve an endorsement on the paper itself, which was the ordinary way that commercial paper is guaranteed. The Court

rejected this hypertechnical interpretation, holding that the obvious intent of Congress was to prohibit banks from holding purchasers or sellers harmless from losses they may incur because of market changes. 295 U.S. at 212.

Petitioner's contention totally distorts *Awotin*. It is petitioner who is attempting to avoid the obvious intent of the statute by devising a technical form of liability that has no relationship to the "hold harmless" problem that Congress intended to avoid by requiring banks to sell or purchase stock without recourse. Schwab's very limited exposure to liability from occasional customer error bears no resemblance to the catastrophic liability a bank could incur by agreeing to protect purchasers of securities from risks in the market, which was the sole focus of Congress's concern in adopting the without recourse limitation in Section 16. See *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. at 211-212.[46] Indeed, the type of liability to the seller that petitioner cites could arise in any transaction when a bank buys or sells securities for a customer, and in effect would read the authorization to buy and sell securities for customers out of the statute. Under any reasonable construction of the without recourse limitation, Schwab's brokerage services are permissible under Section 16.

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[46] Interpreting "without recourse" as limited to an actual assumption of the investment risk does not, as petitioner claims (Pet. Br. 33 n.60), render the phrase superfluous. It still means that the bank will not be permitted to risk its resources in order to create a market for a customer who is having difficulty finding a buyer for a particular security.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APRIL 1984

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No. 83-614

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF RESPONDENT BANKAMERICA CORPORATION

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QUESTIONS PRESENTED

Petitioner challenges a decision of the United States Court of Appeals for the Second Circuit upholding a ruling by the Federal Reserve Board which permitted a bank holding company to acquire a securities brokerage firm that is engaged principally in buying and selling securities on the order and for the account of its customers. The questions presented are:

1. Whether the Court of Appeals correctly upheld the Board's judgment that the activities of the brokerage firm are "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act.

2. Whether the Court of Appeals correctly upheld the Board's interpretation that section 20 of the Glass-Steagall Act does not prohibit affiliation between the holding company and the brokerage firm.

RULE 28.1 STATEMENT

Respondent BankAmerica Corporation owns, directly or indirectly, more than 50 percent but less than 100 percent of the voting stock of the following:

Decimus Corporation
Decimus Computer Leasing Corporation
Banca d'America e d'Italia

BAI Leasing Venture
Finabai-Societe Financiere S.A.
BAI Bank (Cayman) Ltd.

BA Australia Limited

Bamerical Investments (Australia) Limited
Bamerical Nominess (Australia) Proprietary Ltd.

BA (Australia) Holding Proprietary, Ltd.
BA Investors Mgt. Ltd.
BA Australia Leasing Ltd.
Bamerical Proprietary Ltd.
BA (Australia) Hong Kong Ltd.

BancAmerica Options, Inc.
Bank of America Cameroon
BankAmerica Representaco e Servicios Ltd.
Commercial Bank of Africa

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BRIEF OF RESPONDENT BANKAMERICA CORPORATION

STATUTES INVOLVED

This action involves section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982), and section 20 of the Glass-Steagall Act, 12 U.S.C. § 377 (1982). Response to petitioner's arguments also requires consideration of sections 16, 21, and 32 of the Glass-Steagall Act, 12 U.S.C. §§ 24 (Seventh), 378, 78 (1982). With the exception of section 32 of the Glass-Steagall Act, the relevant portions of these statutes are set forth

in petitioner's brief. (Petitioner's Br. at 2-3.) Section 32, in pertinent part, prohibits officer, director, or employee interlocks between any member bank of the Federal Reserve System and any entity

> "primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities." [1]

STATEMENT OF THE CASE

The Statement of the Case in the Brief filed on behalf of the Federal Reserve Board ("Board") and other federal respondents sets forth the background of this case and the history of the proceedings. BankAmerica Corporation ("BankAmerica") adopts that Statement as supplemented below to show that for many years banks and their affiliated companies have engaged in securities brokerage activities pursuant to longstanding regulatory policies which Congress has expressly considered and declined to change.[2]

Before the enactment of banking and securities legislation in the 1930's, both state and national banks were extensively involved in securities activities. Many of these activities continued after passage of that legislation. As the Securities and Exchange Commission ("SEC") reported in 1977:

> "Banks historically have played a major role in securities activities and the securities markets. While the permissible range of bank securities activities was circumscribed by passage of the Glass-Steagall Act in 1933, that Act did not separate the

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[1] 12 U.S.C. § 78.

[2] This case deals with the extent to which nonbank subsidiaries of bank holding companies may provide brokerage services. The activities of banks are relevant because section 4(c)(8) of the Bank Holding Company Act requires the Board to determine whether those services are closely related to banking.

business of commercial banking from all aspects of the securities business. Banks act as underwriters of, and dealers in, U.S. government and municipal securities, manage the investments of others as trustee and agent, and are actively involved in the handling of securities and in the settlement of securities transactions for broker-dealers, institutional customers and others." [3]

Bank securities activities have always involved the provision of brokerage services.[4] For a period of time beginning in the mid-1930's, banks generally did not promote those services to the public—no doubt in part due to early restrictive rulings by the Comptroller of the Currency which discouraged national banks from soliciting brokerage customers.[5] As the Administrative Law Judge found in the Recommended Decision adopted by the Board (21A-23A; 80A; 126A),[6] however, the primary reason that banks did not promote their brokerage services was the existence of stock exchange rules that both fixed brokerage commissions [7] and effectively excluded

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[3] Staff of Senate Comm. on Banking, Housing and Urban Affairs, 95th Cong., 1st Sess., *Reports on Bank Securities Activities of the SEC* 1 (Comm. Print. 1977) (*"Bank Report"*).

[4] *See, e.g., id.* at 1-2. In addition to the activities mentioned above, bank brokerage services have included "dividend reinvestment plans, employee stock purchase plans, automatic customer purchase plans, and customer transaction services." *Id.*

[5] *See* 1 *Bulletin of the Comptroller of the Currency*, No. 2, at 2 (Oct. 26, 1936), discussed in text at 37 *infra.*

[6] Citations to material printed in the Joint Appendix appear as "—A."

[7] From its inception in 1792, the New York Stock Exchange zealously policed a price-fixing cartel, requiring its member firms to charge their customers commissions that were in compliance with the Exchange's commission rate schedule. *See, e.g.*, Former NYSE Rule 383. *See generally*, Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stan. L. Rev. 675, 676 (1970). At

banks from membership on major exchanges.[8] With no way to execute trades for listed securities except by paying fixed commissions to traditional brokerage houses like

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the insistence of the SEC, the Exchange began to relax its price-fixing restrictions in the early 1970's, *see* note 10 *infra*, and by May 1975 the practice had been eliminated. *See* SEC Securities Exchange Act Release No. 10383, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,511 (Sept. 11, 1973); SEC Securities Exchange Act Release No. 10206, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,391 (June 6, 1973). Congress subsequently ratified the SEC's action. *See* Securities Act Amendments of 1975, 15 U.S.C. § 78f(e)(1) (1982) (providing that "no national securities exchange may impose any schedule or fix rates of commissions . . . or other fees to be charged by its members . . . .").

[8] Some exchanges had (and continue to have) express rules excluding banks from membership (*e.g.*, Article XIII, § 13-3 of the Philadelphia-Baltimore-Washington Stock Exchange Guide (CCH) ¶ 1303). The New York Stock Exchange rules accomplished the same result indirectly. Before 1959, the New York Stock Exchange rules flatly prohibited publicly held corporations, the organizational form of most banks, from acquiring membership status. *See generally* Staff of the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., *Securities Industry Study* 69 (Comm. Print 1973). In 1959, the New York Stock Exchange enacted former Rule 318.12 which permitted publicly held corporations to become members, but only if the primary purpose of that corporation or its parent company (if any) was "the transaction of business as a broker-dealer in securities," a test that had the purpose and effect of excluding institutions such as banks. Section 6(b)(2) of the Securities Act Amendments of 1975 removed the ban on institutional membership provided in former Rule 318.12 by requiring that the rules of national stock exchanges provide, subject to certain exceptions, "that any registered broker or dealer . . . may become a member of such exchange and any person may become associated with a member thereof." 15 U.S.C. § 78f(2) (1982). In 1976, the New York Stock Exchange proposed a rule which would have expressly barred banks and bank affiliates from membership. *See* SEC Securities Exchange Act Release No. 12737, 10 SEC Docket 272 (Aug. 25, 1976). The SEC declined to approve the proposed rule, however, largely on the ground that it was anticompetitive and thus inconsistent with Congress' intent to remove the marketplace impediments it earlier had found to permeate various aspects of the securities industry. *Id.* at 278-79.

petitioner's members, banks were unable to offer widespread brokerage services at competitive prices and therefore could not compete for much of that business.

The changing national policy which phased out fixed brokerage commissions during the 1970's made possible expanded brokerage by banking institutions.[9] (23A.) Almost immediately after the initial unfixing of brokerage commissions on institutional transactions in 1971,[10] banks began to promote and solicit customers for automatic investment plans, competing with traditional brokerage houses and passing along the lower commissions made possible by combining their customers' individual orders into larger transactions that could be executed at lower rates.[11] When brokerage commissions on all trades were unfixed in 1975, new low-commission "discount" brokers such as Charles Schwab & Company, Inc. ("Schwab") began to emerge.[12] (23A; 17A.) These

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[9] *See* notes 7 & 8 *supra*.

[10] SEC Securities Exchange Act Release No. 9079, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,955 (Feb. 11, 1971) (requiring that commissions on transactions over $500,000 be fixed by negotiation between the customer and brokerage house as of April 1, 1971).

[11] *See New York Stock Exchange v. Smith*, 404 F. Supp. 1091, 1093 n.1 (D.D.C. 1975), *vacated on other grounds sub nom. New York Stock Exchange v. Bloom*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978). Under automatic investment plans, banks provided lists of corporations to their customers and then periodically purchased for them shares of stock of the companies selected by the customers. Payment was effected by debiting the customer's checking account. *Id.* at 1092-93.

[12] Schwab and firms that engage in similar activities differ from full-service brokerage firms primarily because—unlike such full-service firms—they generally do not provide investment advice or analysis, nor do they engage in underwriting or market-making for corporate stocks and bonds. Discount brokers rely on the volume of the transactions they execute rather than customized service for their profitability. Typically, the commissions they charge for the

brokers included Chemical Bank of New York which introduced (and subsequently terminated) what was apparently the first program of bank "discount" brokerage services in competition with petitioner's traditional brokerage house members.[13]

More recently, changes in technology and consumer demand have made it possible, as well as commercially attractive, to offer brokerage as part of a package of financial services, including integrated and interest-bearing brokerage/cash accounts with credit or debit card privileges and check writing access. (36A-38A; 130A-131A.) These changes coupled with the profit opportunities resulting from the unfixing of commissions provided banks with increasing incentives to expand their brokerage activities. Responding to those incentives, BankAmerica announced in late 1981 that it intended to apply to the Board for authority to acquire Schwab.[14] Shortly thereafter, Security Pacific National Bank began promoting its version of "discount" brokerage,[15] and other banking institutions have followed suit.[16]

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transactions they execute are significantly lower than those charged by full-service firms, and they are thus referred to as "discount" brokers. (127A.) *See* Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 Mich. L. Rev. 1498, 1498-99 (1983).

[13] *See* Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor*, 97 Banking L.J. 811, 829-31 (1980).

[14] BankAmerica sought to acquire directly The Charles Schwab Corporation and thereby acquire its wholly owned subsidiary, Schwab. (125A.)

[15] *See Security Pacific Nat'l Bank*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284 (O.C.C. Aug. 26, 1982), *aff'd in part sub nom. Securities Indus. Ass'n v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *cross appeals pending*, Nos. 84-5026 and 84-5085 (D.C. Cir. 1984).

[16] *See* Note, *Discount Brokerage*, 81 Mich. L. Rev., at 1499-1500 & n.9. According to petitioner (Petitioner's Br. at 4-5), its members

The bank regulatory agencies, recognizing the public benefits, generally supported these efforts. That support represents a continuation of regulatory policy based on longstanding administrative practice and interpretation of governing statutory standards. Specifically, the Glass-Steagall Act since its inception has expressly authorized national banks to provide brokerage services. 12 U.S.C. § 24 (Seventh). The Comptroller, whose early rulings limited the offering of such services, had relaxed his rulings well before the decision in 1974 upholding the right of national banks to promote expanded brokerage services through automatic investment plans.[17] The Board, as the agency primarily responsible for enforcing major provisions of the Act, has never construed the Act to prohibit brokerage by bank holding companies or their non-bank affiliates and has long interpreted relevant terms in the Act to permit brokerage activities.[18]

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are today feeling the effects of competition from more than 600 depository institutions that have commenced promoting "discount" brokerage services in one form or another. *See* Wall St. J., Mar. 7, 1983, at 20, col. 2. Petitioner errs, however, by placing all depository institutions in the same category as banks. Significantly, federal savings and loan associations are regulated by the Federal Home Loan Bank Board ("FHLBB") and the Federal Savings and Loan Insurance Corporation and are not subject to the Glass-Steagall Act. *See* 12 U.S.C. §§ 1464(a), 1725-30 (1982). The monitoring of the FHLBB referred to in petitioner's brief (Petitioner Br. at 6) came in the context of Congress having recently considered exhaustive new legislation pertaining to those associations and, in any event, does not refer directly or indirectly to brokerage activities. *See* Thrift Institutions Restructuring Act, Pub. L. No. 97-320, Title III, 96 Stat. 1469, 1496 (1982). Nonmember state banks are similarly in a different posture since they are subject only to section 21 of the Glass-Steagall Act. Because they are not subject to section 20—the part of the Glass-Steagall Act at issue here—nothing in that Act prohibits them from being affiliated even with underwriting firms.

[17] *See* text at 37 & note 80 *infra*.

[18] *See* 22 Fed. Res. Bull. 51 (1936), discussed in text at 28 *infra*.

Beginning in the early 1970's and continuing to the present, Congress has been well aware of bank securities activities and the actions of the bank regulatory agencies. Changes in the capital markets, including the abandonment of fixed commissions, have commanded major congressional attention, part of which has been focused on brokerage.[19] For example, throughout the period Congress has considered whether increasing bank brokerage activity warranted bringing banks within the jurisdiction of the SEC under the Securities Exchange Act of 1934, or whether it was preferable to have regulation remain at the banking agencies.[20] Congress has also con-

[19] In 1973, for example, Senator Brooke introduced legislation addressed to the provision of brokerage services by banks in the form of automatic investment plans which he noted were being "aggressively marketed" to the public. 119 Cong. Rec. 37,213 (1973). *See also Securities Activities of Commercial Banks: Hearings on the Expansion of Commercial Banks' Securities Business Operations and the Elimination of Barriers Between the Banking and Securities Industries Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. 145, 167-68 (1975) (statement of Roderick M. Hills, Chairman, SEC) ("banks offer to the public many services comparable to the services offered by brokers"); *Brokerage and Related Commercial Bank Services: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 1 (1976) ("This week's hearings will focus on the brokerage and brokerage-related services commercial banks . . . are providing to investors.").

[20] In 1975, Congress directed the SEC to study and report on the securities activities of banks and to determine whether they should be subject to additional regulation. 15 U.S.C. § 78(a)(1)(E) (1982). In its 1977 Reports to Congress in response to this directive, the SEC acknowledged the "major role in securities activities and securities market" played by banks, *Bank Report* at 1, but advised against subjecting banks to SEC regulation, *id.* at 305. The SEC did, however, recommend legislation intended to strengthen the regulatory scheme administered by the banking agencies. *Id.* at 307-08. The SEC is now considering proposed Rule 3b-9 which, if promulgated, would subject banks to regulation as broker/dealers under the Securities Exchange Act of 1934. *See* SEC Securities Exchange Act Release No. 20357, 48 Fed. Reg. 51,930 (1983).

sidered legislative proposals designed explicitly to modify the language of section 4(c)(8) of the Bank Holding Company Act in ways that would have affected the brokerage activities of holding companies and their nonbank affiliates. Some of these proposals dealt directly with the "closely related" standard;[21] including one, "strongly endorsed" by petitioner's members (who complained about the brokerage activities of Chemical Bank and others),[22] that would also have expressly prohibited affiliates from soliciting "the purchase or sale of any security."[23]

During this time, Congress has revised other aspects of the banking laws, including those dealing directly with bank holding companies. In the Garn-St Germain Act[24] passed in 1982 (well after BankAmerica's application to acquire Schwab was filed and after the Comptroller's

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[21] *E.g.*, H.R. 2856, § 6(a), 96th Cong., 1st Sess. (1979); S. 39, § 301(a), 96th Cong., 1st Sess. (1979); S. 72, § 301(a), 95th Cong., 1st Sess. (1977); S. 2721, § 301(a), 94th Cong., 1st Sess. (1975). *See* note 45 *infra*.

[22] *Bank Holding Company Legislation and Related Issues: Hearings on H.R. 2747 Before the Subcomm. on Financial Institutions of the House Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 908 (1979) (statement of John F. Donahue, Jr.).

[23] H.R. 2747, § 8, 96th Cong., 1st Sess. (1979) (proposing to amend section 4(c)(8) to provide that "it is not closely related to banking to . . . underwrite, distribute, or solicit the purchase or sale of any security").

A number of bills have been introduced recently proposing to amend section 4(c)(8) to permit bank holding companies to engage in "services of a financial nature" and to require that certain securities activities (including brokerage) be carried out in separate securities affiliates. *See, e.g.*, S. 2181, § 104(d), 98th Cong., 1st Sess. (1983); S. 1609, § 10, 98th Cong., 1st Sess. (1983); S. 2490, §§ 8, 10, 97th Cong., 2d Sess. (1982); H.R. 6720, §§ 8, 10, 97th Cong., 2d Sess. (1982). *See also* S. 2134, § 5, 98th Cong., 1st Sess. (1983).

[24] Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Title VI, 96 Stat. 1469.

ruling that national banks may engage in "discount" brokerage), section 4(c)(8) was amended expressly to limit insurance activities. But during the entire period, Congress has never acted to limit securities brokerage activities.

SUMMARY OF ARGUMENT

Section 4(c)(8) of the Bank Holding Company Act authorizes the Board to allow a bank holding company to engage in nonbanking activities if the Board determines that the activity is "so closely related to banking as to be a proper incident thereto" and that the holding company's activity may reasonably be expected to produce public benefits. The Board concluded that the activities involved in this case—acting as agent in arranging for the purchase and sale of securities on the order of and for the account of customers—satisfied the requirements of section 4(c)(8), and the court below affirmed. Petitioner claims error, arguing first that the Board employed an inappropriate standard in determining that the activities were closely related to banking and second that the Glass-Steagall Act prohibits the holding company from engaging in brokerage.

I

The Bank Holding Company Act confers substantial discretion upon the Board in determining whether the relationship between a proposed section 4(c)(8) activity and banking is "close." The statute does not prescribe the precise factors the Board is to consider. Rather, the Act and its legislative history make clear that the Board should apply its expertise and experience in determining whether the relationship is a close one. This Court has ruled that Board determinations under section 4(c)(8) are "entitled to the greatest deference." *Board of Governors v. Investment Company Institute* ("*ICI II*"), 450 U.S. 46, 56 (1981).

The Board applied its expertise in this case to a record that plumbed in depth the activities of banks and brokers in performing brokerage functions. The Board found that banks have provided a variety of brokerage services and have routinely engaged in arranging for the purchase and sale of securities for the account of customers; that bank activities and the brokerage services offered by Schwab, while differing in minor respects, are "operationally and functionally very similar"; and that banks are particularly well equipped with technology and personnel to offer these services. Those findings articulate a wholly rational basis for concluding that the brokerage services at issue are closely related to banking.

Petitioner argues that it was improper for the Board to consider the "functional similarity" between the services provided by banks and brokers and that a nonbanking activity can be "closely related" to banking only if it "facilitates" other banking services. Petitioner's arguments are not supported by the statutory language or legislative history. They are wholly inconsistent with this Court's decision in *ICI II*. They conflict with the approach consistently followed by the Board and by every court of appeals that has considered the statute. The court below properly rejected them, and its holding that the Board acted well within its discretion should be affirmed.

II

The Glass-Steagall Act governs the securities activities of national banks on the one hand and their affiliates on the other. Section 20 of the Act is the only provision relevant here. It prohibits banks from affiliating with a company engaged "principally" in the "issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndication," of securities—statutory language that this Court has said refers to the "underwriting field" and which the Board's regulations have interpreted since 1936 as excluding brokerage.

Petitioner challenges the Board's longstanding interpretation of the Act and argues that the words "public sale" in section 20 should be read to include brokerage. However, as the court below held, the Board's reading gives the words of the statute their natural meaning, is supported by well established principles of statutory construction, and is in full accord with the purposes of the Act. Brokerage activities do not present the risks that concerned Congress when it passed the Act.

Petitioner argues that section 16 of the Glass-Steagall Act—the section that governs the securities activities of national banks, not their affiliates—limits the brokerage services that banks can offer and that a "consistent reading" of the Act requires that these limitations be read into section 20 as well. Section 16 does not so limit banks. In any event, this Court has already held that the Glass-Steagall Act permits bank affiliates to engage in securities activities prohibited to banks. *ICI II*, 450 U.S. at 60. The court below correctly concluded that even if banks were limited in the brokerage services they may provide, the Act does not and was not intended to impose such limitations on bank affiliates.

ARGUMENT

I. THE BOARD PROPERLY DETERMINED THAT SECURITIES BROKERAGE IS CLOSELY RELATED TO BANKING.

The activities of bank holding companies and their nonbank subsidiaries are governed by the Bank Holding Company Act. The Act generally prohibits bank holding companies from engaging in nonbanking activities but sets forth certain specific exceptions. One of those exceptions is found in section 4(c)(8), which provides that bank holding companies and their nonbank affiliates may engage in activities which the Federal Reserve Board finds are "so closely related to banking . . . as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8). In considering whether a proposed activity is "proper" for a particular bank holding company, the Board is in-

structed to weigh the public benefits of the activity, taking into account factors such as public convenience, efficiency, increased competition, and effects on sound banking practice. *Id.*

In this case, the Board considered whether BankAmerica's acquisition of Schwab would satisfy the requirements of section 4(c)(8). Schwab is engaged in arranging securities transactions for its customers. (127A; 17A-19A.) Its principal activity is pure brokerage—*i.e.*, it arranges for the purchase and sale of securities solely as agent, on the order and for the account of customers. (127A; 18A.)[26] The Board found a wide array of public benefits attendant upon BankAmerica's offering brokerage services through Schwab. (134A-136A; 146A.) That finding is uncontested. The Board also concluded that the undisputed facts of record demonstrated that these services were "closely related" to banking. (128A-133A.)

The Board relied upon three principal factors in concluding that the brokerage services that BankAmerica would provide after acquiring Schwab are "closely related" to banking:

> 1. The Board first looked at the extent to which banks have performed brokerage services. The principal activity of a broker is to arrange the purchase or sale of securities for customers. (31A.) Banks have engaged in this type of activity for decades. (129A; 25A-34A.) The Board found that through the trading desks of trust departments, "banks routinely buy and sell securities" for the account of customers. (129A; 25A-34A.) Moreover, banks engage extensively in effecting securities transactions in municipal and government securities and have

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[26] Schwab also offers incidental supporting services such as margin lending, custodial accounts, and appropriate account maintenance. (127A.) The Board examined these services and found them to be closely related to banking. Petitioner did not question the Board's conclusions in this respect in the court below and does not challenge them now.

offered other programs to the public for direct customer brokerage service. (129A; 27A-28A.)[26]

2. The Board next examined the precise ways in which banks and brokerage firms deal with securities transactions and found that they were "operationally and functionally very similar." (129A.) In engaging in securities activities, banks perform the same functions, utilize the same techniques, employ persons with the same training, and use the same facilities as brokers. (129A-131A.) The Board also examined petitioner's contention that banks historically have been excluded from stock exchanges and therefore have not executed transactions in listed securities on the exchange floors. Here it found that banks executed many other types of securities transactions and that, even where banks used an intervening broker for exchange execution, their role has often been so substantial as to leave the intervening floor broker only a ministerial task. (129A-130A.)[27]

3. Finally, the Board specifically considered the extent to which banking organizations were able to deal with the technological demands inherent in offering brokerage services. Here it found that the use of sophisticated techniques, resources, and personnel to execute orders for the purchase or sale of securities for the account of customers is sufficiently widespread in the banking industry to justify the conclusion that banking organizations are particularly well equipped to offer this type of service. (129A; 130A-131A.)

The court below held that the Board's factual findings were "clearly" supported by substantial evidence and that the tests it applied were reasonable and well within its discretion. (172A-174A.)

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[26] The record also contains documentation of BankAmerica's own extensive activity in the brokerage field. (34A-36A.)

[27] The Board also found that many brokers utilize floor brokers for the formal execution of listed securities. Schwab itself until recently used an intervening broker for floor execution on the New York Stock Exchange. (17A; 32A.)

Petitioner assumes that the securities brokerage business is not an activity in which banks themselves may engage. (Petitioner's Br. at 15.) Petitioner then argues that the Board could not properly find that brokerage is "closely related" to banking unless it specifically determined that brokerage directly and significantly "facilitates" other banking activities. (Petitioner's Br. at 13, 15.)[28] Petitioner argues that the Board was in error because it made no such finding here. Rather, petitioner contends that the Board rested its determination solely upon the "functional similarity" between brokerage and banking and, in so doing, applied a test which Congress rejected in the 1970 Amendments to the Bank Holding Company Act.[29] (Petitioner's Br. at 15, 18.) Petitioner's

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[28] Petitioner's facilitation argument derives in part from a statement of former Board Chairman Martin that petitioner presents out of context. (Petitioner's Br. at 13-14.) Chairman Martin testified that:

> "On the basis of the language of the statute and its legislative history, the Board has interpreted the section 4(c)(8) exemption to mean that there must be a direct and significant connection between the proposed activities of the company to be acquired and the business of banking, or of managing and controlling banks, *as conducted by the bank holding company or its banking subsidiaries.*"

Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Committee on Banking and Currency, 91st Cong., 1st Sess. 199 (1969) (emphasis added as to portion omitted by petitioner). The statement was designed to persuade Congress to permit bank holding companies "to engage in 'related' activities without showing such a close connection between the business and that of a subsidiary bank." *Id.* Congress ultimately agreed and deleted the requirement. *See* text at 20 *infra*.

[29] Petitioner's argument that the Board applied a test solely of functional similarity is based on misquotation of the Board's order (Petitioner's Br. 15). The Board found that the brokerage business is "*operationally and functionally very similar*" to the brokerage activities of banks, and relied on other factors as well. *See* text at 13-14 *supra*.

contentions have already been rejected by this Court; they violate the language and the intent of the Bank Holding Company Act; and they proceed, in any event, upon the erroneous assumption that securities brokerage is not itself a banking activity that is *a fortiori* closely related to banking.

First, this Court disposed of petitioner's contentions just three years ago in *ICI II*, 450 U.S. 46. There this Court upheld the Board's determination that the activity of sponsoring, managing, and advising a closed-end investment company was closely related to banking. This Court did not require that the Board find that the activity "facilitated" other banking operations. (As the court below noted, the activity clearly did not.) (174A.) Nor did this Court believe that the Board had erred in examining the similarity between the functions traditionally performed by banks and the activity which the Board approved. Rather, relying precisely upon the similarity of function, this Court reasoned that:

> "The services of an investment adviser are not significantly different from the traditional fiduciary functions of banks. The principal activity of an investment adviser is to manage the investment portfolio of its advisee—to invest and reinvest the funds of the client. Banks have engaged in that sort of activity for decades. As executor, trustee, or managing agent of funds committed to its custody, a bank regularly buys and sells securities for its customers. Bank trust departments manage employee benefit trusts, institutional and corporate agency accounts, and personal trust and agency accounts. Moreover, for over 50 years banks have performed these tasks for trust funds consisting of commingled funds of customers. . . . The Board's conclusion that the services performed by an investment advisor are "so closely related to banking . . . as to be a proper incident thereto" is therefore supported by banking

practice and by a normal reading of the language of § 4(c)(8)." [30]

Second, the language of the Act itself refutes petitioner's claims. That language instructs the Board to consider the "closeness" of an activity to banking. It does not say that the Board must find that the activity "facilitates" other banking operations. Much less does it suggest that "facilitation" is an exclusive test which the Board must employ or that functional similarity may not be considered as a factor by the Board.[31] Rather, the language is general in nature. It does not specify the factors which the Board should examine,[32] nor the weight to be accorded the factors that the Board takes into account. Any normal reading of the statute would suggest that the Board has discretion to consider and

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[30] 450 U.S. at 55-56 (citations omitted). Petitioner notes (Petitioner's Br. at 16) the language in *ICI II* to the effect that:

> "Because the authority for any specific investment advisory relationship must be preceded by a further determination by the Board that the relationship can be expected to provide benefits for the public, the Board will have the opportunity to ensure that no bank holding company exceeds the bounds of a bank's traditional fiduciary function of managing customers' accounts."

450 U.S. at 57. Here the Board exercised that opportunity and found that Schwab's activities (which the Board found not to be significantly different from the brokerage activities of banks) would provide substantial public benefits. (134A-136A; 129A.) Petitioner does not contest the Board's public benefits determination.

[31] The Board's ruling does not create a precedent for banks to engage in the retail consumer sale of goods business or the telephone business. (Petitioner's Br. at 18-19.) The Board would consider functional similarity as one factor in evaluating the relationships of these activities to banking activities, just as it did in analyzing the brokerage business here.

[32] In contrast, Congress specfied a number of factors for the Board to consider in making the public benefits determination of section 4(c)(8). 12 U.S.C. § 1843(c)(8).

weigh a variety of factors. Both the Board and every court that has examined the statute have so held.[33]

[33] *See National Courier Ass'n v. Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975), where the court specified three factors that the Board may properly consider, namely whether:

> "1. Banks generally have in fact provided the proposed services.
>
> 2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> 3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form."

Id. at 1237. Those factors have been adopted both by the Board and by all of the courts of appeal that have considered the question. (128A; 171A.) *See Alabama Ass'n of Insurance Agents v. Board of Governors*, 533 F.2d 224, 241 (5th Cir. 1976), *modified*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978); *Association of Bank Travel Bureaus, Inc. v. Board of Governors*, 568 F.2d 549, 551 (7th Cir. 1978); *NCNB Corp. v. Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979). Moreover, the court in *National Courier* stressed that the Board should examine the whole nexus between an activity and banking. 516 F.2d at 1237. Indeed, *National Courier* squarely rejected petitioner's view of the closely related determination by approving the activity of transportation of financially related materials for the general public as closely related to banking. *Id.* at 1239.

While petitioner relies heavily on *Alabama Association* in support of its facilitation argument, that case not only embraced the *National Courier* factors but acknowledged as well the need to look at the broad nexus between an activity and banking. *Alabama Ass'n*, 533 F.2d at 240-41, *as modified*, 558 F.2d at 730. *Alabama Association* did approve certain activities (such as insurance on loan collateral) because they facilitated bank loan operations. 533 F.2d at 240. But the court plainly did not view facilitation as a mandatory requirement; it was only one of a number of relationships the court considered in making the "closely related" inquiry. With regard to other insurance activities, the court noted that the Board had not made sufficient factual findings to support a close relationship between them and banking. *Id.* at 241. On rehearing and upon a more complete factual showing by the Board, the court

Third, the legislative history of the 1970 Amendments to the Bank Holding Company Act precludes petitioner's arguments. This Court has previously examined that history and concluded that it is difficult to discern the precise metes and bounds of the "closely related" test. *ICI II*, 450 U.S. at 56 n.20. But there is no doubt about one choice made by Congress in the 1970 Amendments to the Act. Congress deliberately chose to retain the general language of the Act which, on its face, permits the Board to consider and weigh a variety of factors in determining whether an activity is closely related to banking.[34] It did so despite strenuous efforts in the House to encumber the Board's discretion.[35] Indeed, in recognition of the broad discretion invested in the Board under the "closely related" determination, Congress added a public benefits test to require that the Board address a number of other factors in each individual case before authorizing a bank holding company to engage in a specific activity.[36]

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reversed itself in part and upheld the Board's conclusion that selling insurance in communities with less than 5,000 population is closely related to banking. 558 F.2d at 730.

[34] In *ICI II*, this Court quoted extensively from the legislative history in showing that Congress intended that the Board have considerable flexibility in making the closely related determination. 450 U.S. at 56-57 & n.23.

[35] The House bill was amended on the floor to include a "laundry list" of specific types of business activities that would be prohibited to bank holding companies. 115 Cong. Rec. 33,133, 33,139 (1969). The addition of this list occasioned a bitter fight on the floor with opponents arguing that it was essential to leave the Board's discretion untrammelled. 115 Cong. Rec. 33,135 (1969) (remarks of Rep. Rees); *id.*, at 33,137 (remarks of Rep. Brown); *id.* at 33,138-39 (remarks of Rep. Ashley). When the Bill finally emerged from Conference the laundry list was deleted and the views of those favoring a flexible discretionary approach prevailed. H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. 13 (1970).

[36] 115 Cong. Rec. 33,139, 33,140 (1969); H.R. Rep. No. 387, 91st Cong., 1st Sess. 14-15 (1969); S. Rep. No. 1084, 91st Cong., 2d Sess. 13-14 (1970); H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. 16-18 (1970).

The 1970 Amendments also expanded the permissible activities of bank holding companies. As noted by this Court:

> "The 1956 version had required a close connection to the 'business of banking.' The 1970 Amendments required only a close connection to 'banking.' This change eliminated the requirement that bank holding companies show a close connection between a proposed activity and an activity in which the holding company or its subsidiary already actually engaged. Thus the 1970 amendment to § 4(c)(8) permitted bank holding companies to engage in any activities closely related to activities generally engaged in by banks."[87]

Petitioner makes much of the fact that in its deliberations relating to this expansion Congress considered changing the "closely related to the business of banking" test to one of "functionally related to banking." (Petitioner's Br. at 1[illegible].) It appears that most legislators believed that the words "closely related" and "functionally related" were not significantly different.[88] During con-

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[87] *ICI II*, 450 U.S. at 73 n.51.

[88] H. Rep. No. 387, 91st Cong., 1st Sess. 22 (1969) (additional views of Reps. Patman, Barrett, Sullivan, Reuss, Moorehead, St Germain, Gonzales, Minish, Annunzio, Hanley, Abel, Brasco, and Chappell); 116 Cong. Rec. 42,432-37 (1970) (remarks of Sen. Bennett); *id.* at 42,432-33 (remarks of Sen. Sparkman). In the Conference Committee report, Representative Patman, joined by three of the six other House conferees, suggested that the "functionally related" standard might be broader than the "closely related" standard ultimately adopted. H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. 21 (1970). This view contradicted Representative Patman's own earlier statements on the subject. H.R. Rep. No. 387, 91st Cong., 1st Sess. 22 (1969). Some legislators believed that the "closely related" formulation was even more flexible than the "functionally related test." 116 Cong. Rec. 42,433 (1970). In sum, there was, as this Court noted in *ICI II*, 450 U.S. at 73, some confusion, as to the precise meaning of the difference in language but the congressional intent is clear at least to expand permissible activities to those closely related to banking generally.

gressional consideration of the 1970 Amendments, the Board also agreed that the difference was not significant and expressed the view that the formulation used did not matter so long as it was made clear that the Act did not require a direct and significant connection between the "closely related" activity and the business of the holding company's bank subsidiary.[39] Congress thereupon altered the statute so that the Board need only find a close relationship to activities generally engaged in by banks and then retained the closely related language. Nothing in this legislative history suggests—even remotely—that the Board should not consider functional relationships as one factor in determining whether an activity is closely related to banking.

In any event, petitioner's entire argument assumes that the securities brokerage business is not itself a banking activity. However, section 16 of the Glass-Steagall Act affirmatively added brokerage to the express powers of national banks contained in 12 U.S.C. § 24. Petitioner's own reading of section 16 establishes that securities brokerage is a banking activity at least for all bank customers.[40] Even if the brokerage activity permitted by section 16 were somehow limited to bank customers, there is no reason why a bank holding company may not offer a proper banking service to a wider audience. Most bank holding company services are offered to the public at large and not merely to bank customers, and that is what the Bank Holding Company Act intends.[41] The Board had ample reason to justify service to a wider audience here.

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[39] H.R. Rep. No. 1747, 91st Cong., 2d Sess. 16 (1970) (statement of former Board Chairman Arthur Burns).

[40] In fact, section 16 is not so restricted. *See* text at 38-41 *infra*.

[41] The Bank Holding Company Act in its present form has special provisions for affiliate activities that support or service subsidiary bank activities. 12 U.S.C. § 1843(c)(1)(C). Section 4(c)(8) in contrast governs holding company activities dealing

In sum, the Board clearly applied an appropriate test in determining that brokerage activity was closely related to banking. The Board carefully examined the complex of relationships between Schwab's activities and the activities traditionally performed by banks, finding (1) that banks have in fact provided a variety of brokerage services, (2) that Schwab's brokerage services are "operationally and functionally very similar" to the brokerage and other securities activities of banks, and (3) that banking organizations are well equipped to provide these services. (129A.)[42] In other portions of its order, the Board noted the likelihood of customer convenience and transactional efficiencies that would result from BankAmerica's operation of the business. (134A-136A.)

The courts have consistently held that the Board may examine these factors.[43] The Board has done so for many years.[44] Although petitioner now proposes a different test in this Court,[45] even petitioner urged virtually identical

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with the general public. 49 Fed. Reg. 794, 807-08 (Jan. 5, 1984) (to be codified at 12 C.F.R. § 225.22); *see National Courier*, 516 F.2d at 1239. The Bank Holding Company Act was amended in 1970 to make clear that affiliates were not limited to supporting the business of the subsidiary bank. *See* text at 20 *supra*. This change embodies the concept that bank holding companies will deal with a public other than the bank's customers. The same conclusion follows from the "*public* benefits" test of section 4(c)(8), which on its face contemplates that bank holding companies will engage in activities with the public.

[42] The Board did not approve the application, as petitioner suggests, merely upon a finding of functional similarity. (Petitioner's Br. at 15, 18.) *See* text at 13-14 *supra*.

[43] *See* note 33 *supra*.

[44] Adoption of petitioner's proposed standard would call into question years of prior administrative practice during which the Board has not employed the tests urged by petitioner.

[45] Others have proposed to Congress changes to the "closely related" test that are similar to that advocated to this Court by petitioner. Bills have been proposed to limit bank holding company activities to those "so closely *and directly* related to banking . . . as

standards in arguing to the Board.[46] Application of the closely related test lends itself to the exercise of discretion by the agency based on its considerable expertise in banking matters.[47] The court below was clearly correct in concluding that the Board's determination was appropriate and well within its discretion.

II. THE GLASS-STEAGALL ACT DOES NOT PROHIBIT A BANK AFFILIATE FROM PROVIDING BROKERAGE SERVICES.

The Glass-Steagall Act was enacted in 1933 to address problems which Congress believed had been caused by excessive speculation and underwriting activities by banks in earlier years.[48] The Act did not bar banks and bank affiliates from all aspects of the securities business, and they have continued to engage in a broad spectrum of

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to be a proper *and necessary* incident thereto." H.R. 2856, § 6(a), 96th Cong., 1st Sess. (1979) (emphasis added); S. 39, § 301(a), 96th Cong., 1st Sess. (1979); S. 72, § 301(a), 95th Cong., 1st Sess. (1977); S. 2721, § 301(a), 94th Cong., 1st Sess. (1975). Congress has not adopted these proposals.

[46] Before the Board petitioner relied on the *National Courier* standards and argued that banks' brokerage activities were not "operationally or functionally similar" to the brokerage business.

> "As we shall demonstrate below, [BankAmerica] has failed to meet its burden with respect to the *National Courier* tests. Banks have neither generally engaged in the activities which Schwab conducts, nor have they generally engaged in activities that are operationally or functionally similar to those of Schwab."

Post Hearing Brief of the Securities Industry Association at 21-22, 36-48 (citations omitted). It was not until the Board ruled against petitioner under the tests petitioner advocated that petitioner first argued for a "facilitation" requirement.

[47] As this Court has stated, "[t]he Board's determination of what activities are 'closely related' to banking is entitled to the greatest deference." *ICI II*, 450 U.S. at 56.

[48] *See, e.g., ICI II*, 450 U.S. at 61-62; *Investment Co. Institute v. Camp ("ICI I")*, 401 U.S. 617, 629-30 (1971).

securities activities.[49] Examination of the Act's specific provisions is essential to a determination of whether any particular activity exceeds the bounds of the Glass-Steagall Act and here reveals the correctness of the Board's decision.

A. Section 20 Is the Only Relevant Statutory Provision and Permits a Bank Affiliate To Provide Brokerage Services.

Section 20 is the only provision of the Glass-Steagall Act that deals directly with the securities activities of bank holding companies and their nonbank subsidiaries. Section 20 prohibits affiliates of Federal Reserve System member banks from engaging "principally" in the "issue, flotation, underwriting, public sale, or distribution at wholesale or retail, or through syndication," of securities.

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[49] Petitioner cites *ICI II* for the proposition that "[t]hrough the Glass-Steagall Act, Congress meant to separate depository institutions from the securities business 'as completely as possible.'" (Petitioner's Br. at 20.) In fact, as the Board noted (152A), what this Court said Congress meant to separate was "commercial from investment banking," the latter term plainly referring to the "underwriting field." 450 U.S. at 70. Indeed, in *ICI II* the court of appeals was reversed precisely because it carried too far the separation of bank affiliates from the securities business. *Id.* at 54.

Petitioner's references to remarks made by Representative Kopplemann during the House debates on the Glass-Steagall Act are similarly misleading. (Petitioner's Br. at 20-21.) In context, it is quite clear that Representative Koppelmann was concerned about "the undue diversion of bank funds into speculative operations," 7 Cong. Rec. 3907 (1933), and used the term "brokerage" to refer to the promotion and sale of securities by banks, not brokerage transactions in which banks act as agent for customers. Use of the term "brokerage" loosely to encompass "dealing" and "underwriting" is not unusual, as both the Board (152A) and this Court have noted. *See Board of Governors v. Agnew*, 329 U.S. 441, 445-46 (1947). *See also* N. Moore, *Dictionary of Business, Finance and Investment* 59 (1976) ("brokerage house" refers to "[a]ny firm whether acting as broker or dealer, which assists in securities trading").

BankAmerica's acquisition of Schwab has made Schwab a bank affiliate within the meaning of the Glass-Steagall Act,[50] and the acquisition could be found to violate section 20 only if Schwab is "engaged principally" in any of the activities expressly listed therein.

Schwab's principal activity is buying and selling securities as agent for its customers and not for its own account. Petitioner has, throughout this proceeding, conceded that these activities do not constitute the "issue," "flotation," "underwriting," or "distribution" of securities. (*See, e.g.*, Petitioner's Br. at 7, 10, 35.) As the Board concluded, and the Court of Appeals affirmed, Schwab's brokerage activities also do not constitute the "public sale" of securities.

Interpretation of section 20 necessarily begins with an analysis of its language.[51] Significantly, section 20 does not include "brokerage," the generic term used for buying and selling securities as agent for a customer.[52] Nor does section 20 otherwise refer to the activities of purchasing and selling securities on the order and for the account of customers. Rather, the section refers to the "issue, flotation, underwriting, public sale, or distribution" of securities, the investment banking activities with

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[50] Section 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b) (1982), defines a bank "affiliate" as, *inter alia*, any entity under common control with a bank. Bank of America NT&SA, a member bank, is BankAmerica's principal subsidiary; any other majority-owned subsidiary of BankAmerica is thus an affiliate of a member bank.

[51] *See, e.g., North Dakota v. United States*, 103 S. Ct. 1095, 1102 (1983); *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982).

[52] 2 L. Loss, *Securities Regulation* 1215 (2d ed. 1961) (a "broker" executes an order for securities as agent of his customer; a "dealer" in securities acts for his own account and not as agent for the customer).

which the Glass-Steagall Act is primarily concerned.[53] The term "public sale" has been used both to describe underwriting activities[54] and synonymously with "public offering," a term that plainly connotes underwriting rather than brokerage activities.[55]

Interpreting section 20 to exclude brokerage also gives effect to the familiar principle of statutory construction providing that words grouped in a list should normally be given related meaning.[56] The terms "issue," "flotation," "underwriting," and "distribution" in sections 20 and 32 are generally synonomous and all involve the marketing to the "public" of newly issued stock or of large blocks of securities previously privately held.[57] It

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[53] *See, e.g., ICI II*, 450 U.S. at 61-62; *ICI I*, 401 U.S. at 629-30.

[54] *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 758 (1975) (Powell, J. concurring) (describing "customary public sale" of securities as one involving marketing of issues "through underwriters and dealers, often including scores of investment banking and brokerage firms" where offers are made to "countless persons whose identities cannot be known"). *See also* 1 L. Loss, *Securities Regulation* 551 (2d ed. 1961).

[55] *See, e.g., Spector v. LQ Motor Inns, Inc.*, 517 F.2d 278, 282-83 (5th Cir. 1975), *cert. denied*, 423 U.S. 1055 (1976) (using "public sale" interchangeably with "public offering" by issuer of its own stock); *Steinberg v. Carey*, 439 F. Supp. 1233 (S.D.N.Y. 1977); *Kupferman v. Consolidated Research & Mfg. Corp.*, [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,197 (S.D.N.Y. Dec. 19, 1962); *SEC v. Arvida Corp.*, 169 F. Supp. 211 (S.D.N.Y. 1958); SEC Securities Act Release No. 3844, 22 Fed. Reg. 8359 (1957).

[56] *See, e.g., Third National Bank v. Impac, Ltd.*, 432 U.S. 312, 322 (1977); *General Electric Co. v. Occupational Safety & Health Review Commission*, 583 F.2d 61, 65 (2d Cir. 1978).

[57] The Court of Appeals explained that the terms "issue," "flotation," "underwriting," and "distribution" included activities "in which the dealer trades as principal for his own profit," whereas brokerage refers to agency rather than principal activities. (161A.) Petitioner challenges that analysis claiming that the term underwriting includes "best efforts" underwriting, which occurs when an underwriter, instead of buying an issue from the issuer and

is highly unlikely that, in the midst of words describing activities generically different from brokerage, Congress would have used the words "public sale" to refer to brokerage. This is particularly true where Congress used words that unmistakably describe brokerage activities elsewhere in the Act. The term "public sale" in section 20 stands in sharp contrast to the language in section 16 of the Act which expressly authorizes banks to engage in the "purchasing and selling of securities . . . without recourse, solely upon the order, and for the account of, customers."

The Board's holding that Schwab's brokerage activities do not constitute the "public sale" of securities is further supported by its longstanding interpretation of the same words in section 32 of the Glass-Steagall Act. Section 32 prohibits managerial or other interlocks between member banks and any entity

> "primarily engaged in the *issue*, *flotation*, *underwriting*, *public sale*, *or distribution*, at wholesale or

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reselling it as principal, sells it for the issuer as agent. (Petitioner's Br. at 38-39.) Petitioner cites no authority for the proposition that the term underwriting as used in the Glass-Steagall Act was intended to include best efforts underwriting. Indeed, in the words of the leading commentator cited by petitioner, best efforts underwriting is "not really underwriting, it is simply merchandising." 1 L. Loss, *Securities Regulation* at 172. *See also Quinn & Co. v. SEC*, 452 F.2d 943, 946 (10th Cir. 1971), *cert. denied*, 406 U.S. 957 (1972) ("The term underwriter is . . . a word of art. An underwriter is one *who purchases stock from the issuer* with an intention to resell it to the public.") (emphasis added); *Dale v. Rosenfeld*, 229 F.2d 855, 857 (2d Cir. 1956) (commonly understood meaning of the word "underwriting" does not include best efforts underwriting). In any event, the activities of a best efforts underwriter are markedly different from those of a broker such as Schwab. Best efforts underwriters undertake to sell blocks of securities on behalf of issuers and thus have a "salesman's interest" in the promotion of the particular securities they are trying to sell. Brokers that merely execute orders at the direction of their customers have no similar interest. *See* note 65 *infra*.

retail, or through syndicate participation, of stocks, bonds, or other similar securities." [58]

In January 1936, shortly after section 32 was revised in the Banking Act of 1935, the Board ruled that "[a] broker who [is] engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in Section 32." 22 Fed. Res. Bull. 51 (1936). The Board's regulations have carried that interpretation forward, without change for almost 50 years.[59] Since both sections 32 and 20 contain the same language, were enacted for the same general purpose, are part of the same statute, and deal with the same subject matter, the Board's longstanding interpretation of "public sale" in section 32 to exclude brokerage activities applies with equal force to the same term in section 20. *See Northcross v. Board of Education*, 412 U.S. 427, 428 (1973).

The Board's construction of the term "public sale" was implicitly adopted by this Court in *Board of Gover-*

[58] 12 U.S.C. § 78 (emphasis added).

[59] *See* 12 C.F.R. § 218.1 (1983). Petitioner urges this Court to ignore (and implicitedly overrule) the Board's interpretation here solely because it claims that "there is no indication that the Board's construction of Section 32 was ever brought to Congressional attention, let alone that it led to Congressional action." (Petitioner's Br. at 40 n.72.) That contention is erroneous. As originally enacted in 1933, section 32 prohibited interlocks between a member bank and a firm primarily engaged in the business of "purchasing, selling, or negotiating securities." Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, 194. In the Banking Act of 1935, ch. 614, 49 Stat. 684, 709, Congress revised section 32 in order to make the description of securities activities parallel to that contained in section 20. *See* H.R. Rep. No. 742, 74th Cong., 1st Sess. 17 (1935). Congress had previously been advised that the Board interpreted section 32 as covering only "the underwriting and distribution of securities," 1934 Annual Report of the Federal Reserve Board 53 (1935), and in no way indicated any desire to reach brokerage activities when it used the term public sale.

nors v. Agnew, 329 U.S. 441 (1947).[60] That case involved two directors of a national bank who were also employees of a securities firm which derived approximately 32 percent of its gross income from underwriting, and 47 percent from brokerage. The Board ruled that the directors' outside firm was "primarily engaged" in activities covered by section 32—namely, underwriting—and it ordered the directors to resign from the bank. On review, the court of appeals set aside the Board's order on the ground that the directors' outside firm earned less than half of its revenue from underwriting.[61] This Court reversed and reinstated the Board's order, holding that a firm is "primarily" engaged in a prohibited activity if it is "substantially" so engaged. If the statutory language "issue, flotation, underwriting, public sale, or distribution" had been thought to encompass not only underwriting but brokerage as well, it would have been unnecessary for the Court to construe the meaning of "primarily engaged," since the directors' outside employer was, under any interpretation of the term, "primarily engaged" in underwriting and brokerage taken together.[62]

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[60] *See also ICI II* where this Court referred to the same language in section 20 itself as "prohibit[ing] national banks or state bank members of the Federal Reserve System from owning securities affiliates . . . that are 'engaged principally' in the *issuance or underwriting of securities*." 450 U.S. at 59 n.24 (emphasis added). This Court also construed identical language in section 19(e) of the Glass-Steagall Act, Pub. L. No. 73-66, 48 Stat. 162, 188 (1933), which has since been repealed in pertinent part, Pub. L. No. 89-485, 80 Stat. 236, 242 (1966), as meaning "the issuance or underwriting of securities." *Id.* at 59 n.24, 69 n.43.

[61] *Agnew v. Board of Governors*, 153 F.2d 785 (D.C. Cir. 1946), *rev'd*, 329 U.S. 441 (1947).

[62] Petitioner attempts to avoid the clear import of this Court's *Agnew* decision by asserting that this Court "did not, and did not have to, address the question of whether . . . the term 'public sale' " included brokerage activity. (Petitioner's Br. at 40.) However, this Court did note separately the percentages of income the firm derived from the brokerage business and from the underwriting

Even if the meaning of the statutory language were open to reasonable differences of opinion, the Board's reading of the term "public sale" in sections 20 and 32 as not encompassing brokerage should be dispositive where, as here, it is fully consistent with the purposes of the Glass-Steagall Act.[63] As this Court explained in *ICI II*, the Glass-Steagall Act was enacted to protect the public against bank losses that might result from participation in securities underwriting and speculative or manipulative market-making activities:

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field. 329 U.S. at 445. Moreover, in distinguishing between the firm's underwriting and brokerage businesses, this Court went so far as to define "the underwriting field" in terms identical to that used in sections 20 and 32:

> "The issue, flotation, underwriting public sale or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, or other similar securities."

Id. at 445 n.3. The majority and dissenting judges in the court of appeals in *Agnew* likewise thought it plain that the language "issue, flotation, underwriting, public sale, or distribution" of securities did not encompass brokerage activity. *Agnew v. Board of Governors*, 153 F.2d at 787 n.3, 790; *id.* at 796 (Edgerton, J., dissenting). Indeed, the majority opinion emphasized that "[u]nderwriting and brokerage, although both concerned with securities, are vastly different operations." *Id.* at 790.

[63] The Board has responsibility for administering sections 20 and 32 of the Glass-Steagall Act, and its determination that BankAmerica's application did not violate the Act is, like its determination under section 4(c)(8) of the Bank Holding Company Act, entitled to deference. Contrary to petitioner's suggestion (Petitioner's Br. at 43), the fact that the Board has no rulemaking authority under relevant provisions of the Glass-Steagall Act does not affect the deference due its interpretation. As the Court of Appeals noted, the Board has both "primary responsibility for implementing the Glass-Steagall Act and expert knowledge of commercial banking." (160A.) *See ICI II*, 450 U.S. at 56-57 n.21 (Board's " 'judgment should be conclusive upon any matter which . . . is open to reasonable difference of opinion' "), *quoting Board of Governors v. Agnew*, 329 U.S. at 450 (Rutledge, J. concurring) (construing the Glass-Steagall Act).

"It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression. Congress was persuaded that speculative activities, partially attributable to the connection between commercial banking and investment banking, had contributed to the rash of bank failures. The legislative history reveals that securities firms affiliated with banks had engaged in perilous underwriting operations, stock speculation, and maintaining a market for the bank's own stock, often with the bank's resources." [64]

As the Board found (151A-153A), the agency services provided by discount brokers simply do not present the risks that concerned Congress when it enacted the Glass-Steagall Act.[65]

B. A Comprehensive Reading of the Glass-Steagall Act Is Fully Consistent With a Bank Affiliate's Providing Brokerage Services.

Petitioner attempts to support its interpretation of section 20 by an elaborate argument that the Board's read-

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[64] 450 U.S. at 61-62 (footnotes omitted); *see ICI I*, 401 U.S. at 629-30.

[65] The primary risk associated with underwriting arises from the fact that, from the time an underwriter is committed to purchase an issuer's securities at one price until the same securities are delivered in sales to the public at what is anticipated to be a higher price, the underwriter's own capital is at risk to market movements. These concerns are simply not relevant to Schwab's brokerage activities. Schwab does not buy or sell securities for its own account and therefore does not assume the capital risks of an underwriter. Nor does Schwab have a "salesman's interest" in promoting particular securities to its customers. Its profit is derived solely from the commissions it receives for executing the purchase and sale orders initiated by its customers (without advice from Schwab) and from charges paid by those customers for the incidental services Schwab provides. *See, e.g.*, 2 L. Loss, *Securities Regulation* at 1215 (a broker "has no beneficial interest in the transaction except the commission . . . he receives for his services").

ing of "public sale" in sections 20 and 32 is inconsistent with other sections of the Act. According to petitioner, two other sections applicable to banks—sections 16 and 21—bar "any direct bank involvement" in brokerage, and this bar should be applied to bank holding companies and their nonbank affiliates in order to provide a "comprehensive" interpretation of the statute. (Petitioner's Br. at 35.) Even if petitioner were correct that sections 16 and 21 preclude banks from providing brokerage services to the general public—and we show below they do not[66]—that conclusion would have no bearing on the decision in this case.[67] This Court has expressly held that "bank affiliates may be authorized to engage in certain activities that are prohibited to banks themselves."[68]

Petitioner attempts to avoid this prior ruling by arguing that the different statutory provisions governing

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[66] Although petitioner repeatedly refers to sections 16 and 21 (Petitioner's Br. at 34-42), its argument rests almost entirely on an interpretation of section 16. (*See* Petitioner's Br. at 20-24.) To the extent petitioner argues that the word "selling" in section 21 encompasses brokerage activities it is incorrect. In context, the word "selling," like "public sale" in section 20, was intended to refer to underwriting activities, not brokerage. The Board's interpretation of section 20 is thus fully consistent with sections 16 and 21 and provides for a fully comprehensive interpretation of the Act.

[67] Petitioner acknowledges the Board's consistent interpretation of sections 20 and 32 as not encompassing brokerage, but nonetheless claims that "[t]here is no reason . . . why only two sections of the Act (20 and 32) should be viewed in isolation from the remaining sections (16 and 21)." (Petitioner's Br. at 40 n.72.) The reasons are quite plain: Sections 20 and 32 refer to precisely the same activities—namely, the "issue, flotation, underwriting, public sale or distribution" of securities. The language in section 16, which governs banks, is markedly different and should be interpreted accordingly.

[68] *ICI II*, 450 U.S. at 60; *see id.* at 59 n.24 ("[T]he structure of the Act reveals a congressional intent to treat banks separately from their affiliates."); *Board of Governors v. Agnew*, 329 U.S. at 447-48 ("Congress by the words it chose marked a distinction which we should not obliterate.").

bank affiliates relate only to the permitted *level* of securities activity allowed the affiliates, not to the *substance* of those activities. (Petitioner's Br. at 38.) Thus, petitioner contends that a bank affiliate can only engage "principally" in securities activities expressly permitted banks. However, petitioner offers no support for this theory, one which it has before argued without success in this Court.[69]

Petitioner's theory is contradicted by express statutory provisions which permit bank affiliates to engage in activities specifically prohibited to banks.[70] Moreover, the theory simply does not make sense.[71] In the Glass-Steagall Act, Congress determined to permit bank holding companies to engage in a non-principal way in specific activities wholly forbidden to banks—for example, underwrit-

[69] *See* Brief of *Amicus Curiae* Securities Industry Association in Support of Respondent, at 21, *ICI II*. Petitioner argued in *ICI II* that "[s]ince Congress intended to prohibit banks from operating closed- as well as open-end investment companies. Section 20 logically must be read to prohibit bank affiliates from operating closed- as well as open-end investment companies." *Id.* This Court declined to adopt petitioner's approach. *See ICI II*, 450 U.S. at 64.

[70] For example, section 16 of the Glass-Steagall Act, prohibits a bank from purchasing "for its own account . . . any shares of stock of any corporation." 12 U.S.C. § 24 (Seventh). Bank holding companies and their nonbank subsidiaries on the other hand, are expressly permitted to own the stock of subsidiaries engaged in various authorized activities and to purchase the stock of other companies of any kind as long as the holding does not exceed 5 percent of any issuer's outstanding voting securities. 12 U.S.C. § 1843 (c)(6) (1982).

[71] Given the statutory language, petitioner must concede that section 16 does not prohibit all brokerage services, *i.e.*, it permits at the very least brokerage services as an accommodation to bank customers. Yet, if petitioner's interpretation were correct and "public sale" were construed to mean "brokerage," the result would be that banks could, pursuant to section 16, engage in brokerage, while bank holding companies could not, under section 20, engage "principally" in *permissible* bank activity—a result that would turn congressional intent on its head.

ing—because it rightly concluded that those activities did not present the same risks when carried out through structurally and organizationally separate affiliates. The same rationale would certainly permit bank affiliates to engage in permissible activities in ways that banks cannot.

Petitioner nonetheless devotes a substantial portion of its brief to trying to establish that under section 16 banks may engage only in limited "accommodation" brokerage activities—that is, the provision of brokerage services as an accommodation to pre-existing bank customers.[73] (*See* Petitioner's Br. at 20-31.) Petitioner bases this assertion primarily on one paragraph in the 1933 Annual Report of the Comptroller of the Currency. That report noted that newly enacted section 16, as originally drawn, permitted banks to engage in brokerage with respect to investment securities, but not stock, and recommended that the statute be amended to add the term "stock" explaining:

> "It would appear from the language that a national bank is prohibited from performing the service of purchasing or selling corporate stocks for the account of one of its customers. Since this does not entail investment by the bank of its own funds and the bank merely acts in an accommodation capacity, it is believed that it was not the intention of Congress to penalize the public located in communities removed from the money centers in disposing of or

[73] In effect, petitioner is attempting to argue the issues it has raised in a different proceeding against the Comptroller. In *Security Pacific Nat'l Bank*, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284 (O.C.C. Aug. 26, 1982), the Comptroller ruled that section 16 does not so limit national banks in the brokerage services they may provide. The district court affirmed that ruling insofar as it is relevant here, *Securities Indus. Ass'n v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), and the decision is now on appeal to the Court of Appeals for the District of Columbia Circuit, Nos. 84-5026 and 84-5085 (D.C. Cir., filed Feb. 9, 1984).

> purchasing securities in the form of corporate stocks for investment purposes." [73]

Petitioner speculates that the Comptroller's reiteration of the word "accommodation" in his testimony before the House and Senate Committees [74] resulted in a congressional understanding that if section 16 were amended to provide for brokerage of corporate stock, banks would thenceforth be limited to providing brokerage as an accommodation to pre-existing customers.[75] (Petitioner's Br. at 24-25.)

Petitioner elevates the Comptroller's concern about an oversight in the legislative process (which would redound to the particular detriment of investors in rural areas) into an effort to persuade Congress to abandon its clearly expressed intention to permit banks to continue to engage in brokerage activities as they had before passage of the Act.[76] If Congress had been concerned that the addition

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[73] 1933 Annual Report of the Comptroller of the Currency 11 (1934).

[74] *Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 154-55, 663 (1935) (statement of J.F.T. O'Connor).

[75] There is no reason to believe that use of the term "customer" in either the legislative history or the statute was intended to limit a bank's potential brokerage clients. Rather, as a plain reading of the statute makes clear, the term was meant to distinguish permissible brokerage activities from securities activities undertaken by banks "for their own account," which were prohibited. Indeed, it is difficult to understand—and petitioner never explains—why either the policies underlying the Glass-Steagall Act or the reasons underlying the Comptroller's call for amendment to the statute would be served by a pre-existing customer limitation.

[76] *See* text at 40-41 *infra*. The Comptroller's own actions are inconsistent with petitioner's view. As petitioner notes, the Comptroller in a letter to the national bank examiners permitted national banks "to purchase and sell stocks solely upon the order and for the account of customers" after the passage of the 1933 Act but before the 1935 amendments. (Petitioner's Br. at 23-24.) If the

of stock to the provisions of section 16 called for some modification of bank brokerage business, the legislative history would surely have suggested as much. Yet neither the House nor Senate Report, nor any floor comment reflects such concern, and the word "accommodation" appears only in the Comptroller's testimony and then with no elaboration or particular indication of significance.[77]

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power of banks to engage in brokerage with respect to stock were as controversial as petitioner suggests, neither the Comptroller nor the Board, *see* note 77 *infra*, would have been likely to adopt such a position without further deliberation, if at all.

Petitioner's reference (Petitioner's Br. at 24) to a statement in the Comptroller's letter to the effect that banks may not engage in the brokerage business is without substantive significance. The Comptroller's letter was expressly concerned with regulating the commissions banks would charge for brokerage service and sought to prevent banks from realizing a profit by restricting those charges to cost. In that connection, the Comptroller stated that while national banks could act as agents for the purchase and sale of stock, "[t]his does not mean that national banks may do a brokerage business *and any charge must not exceed the actual cost of servicing.*" "National Banks May Buy and Sell Stocks," Am. Banker, July 10, 1934, at 1, col. 3 (the italicized portion was excluded from the quotation in petitioner's brief) (reprinting Comptroller's letter). The language in the letter supports the view that it represents prudential regulation rather than statutory construction. Section 16 on its own terms refers to the "business of dealing in investment securities," and thereby permits banks to charge commissions. Moreover, there is no reason to believe that the statement referring to brokerage in the letter was ever brought to Congress' attention.

[77] Petitioner incorrectly suggests that the Board adopted the "accommodation" restriction on brokerage activities of banks. (Petitioner's Br. at 24.) In the Federal Reserve Bulletin petitioner cites, the Board independently ruled that state member banks which are subject to section 16's requirements, 12 U.S.C. § 335, could provide brokerage services with respect to stock as well as investment securities. In so doing, the Board *never* used the word accommodation, nor did it adopt any restrictions petitioner urges this Court to read into the statute. *See* 20 Fed. Res. Bull. 609 (1934). *See also* 1935 Annual Report of the Board of Governors of the Federal Reserve System 56 (1936). What the Board did do was to note without comment in the last paragraph of its statement the similar inter-

In fact, the 1935 amendments were widely viewed as effecting "technical" and not "substantive" change in the 1933 Act, an interpretation wholly inconsistent with the notion of congressional concern.[78]

Petitioner also relies (Petitioner's Br. at 28) on an administrative ruling issued by the Comptroller in 1936 which limited national banks to providing brokerage services, at cost, "to actual customers of the bank, which customer relationship exists independently and apart from the particular [securities] transaction" involved.[79] But that ruling was not based on any requirement stated in section 16 and did not address any matter of concern brought to Congress' attention before the passage of the Act in 1933 or its amendment in 1935. Instead, as later Comptrollers recognized, the ruling was prudential only, reflecting "the great caution of banking regulations in the years immediately following the 1931-2 debacle" and has accordingly been abandoned.[80]

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pretation by the Comptroller and his accompanying statement that "[t]his does not mean that national banks may do a brokerage business and any charge must not exceed the actual cost of servicing." 20 Fed. Res. Bull. 609. But, as noted above, *see* note 76 *supra*, that reference to the brokerage business related only to prudential price regulation.

[78] *See* H.R. Rep. 742, 74th Cong., 1st Sess. 2 (1935) ("amendments make no fundamental changes in the existing banking laws"); *id.* at 1-2 ("purpose of the amendment is to clarify that national banks may purchase and sell stock for the account of their customers, but not for their own account").

[79] 1 *Bulletin of the Comptroller of the Currency*, No. 2, at 2 (Oct. 26, 1936).

[80] *Bank Automatic Investment Services*, [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272, at 81,360 (June 10, 1974) (Letter from Comptroller James E. Smith to G. Duane Vieth). *See New York Stock Exchange v. Smith*, 404 F. Supp. at 1097 (early interpretations "embodied an overcautious approach to bank regulation reflecting the atmosphere of the years immediately after the 1929 market crash rather than the legisla-

Whatever the import of the Comptroller's early actions, the "accommodation" theory is not supported by the plain reading of the statute, which empowers a bank to engage "in the *business* of dealing in securities and stock" by purchasing and selling "upon the order, and for the account, of customers and in no case for its own account." Section 16 on its face in no way limits bank brokerage activities to "accommodation" relationships. Indeed, the express prohibitions of section 16—that a bank shall not trade securities "for its own account" and "shall not underwrite any issue of securities or stock"—are wholly inapplicable to brokerage activities.[31]

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tive history"). In 1957, the Comptroller modified the restrictive ruling adopted in 1936. Comptroller of the Currency, *Digest of Opinions* ¶ 220A (1957). In 1963, when the Comptroller's *Digest of Opinions* was superseded by the Manual for National Banks, all provisions limiting the securities brokerage activities of national banks were omitted entirely, and, in 1974, the prior restrictive rulings were expressly repudiated. *See Bank Automatic Investment Services*, at 81,360. This change in regulatory approach is wholly consistent with the well established proposition of administrative law, recently confirmed by this Court, requiring that agencies "be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances,'" consistent with their duty to regulate in the public interest. *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Insurance Co.*, 103 S. Ct. 2856, 2866 (1983), *quoting Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968). *See, e.g., American Trucking Ass'n v. Atchison, T. & S. F. Ry.*, 387 U.S. 397, 416 (1967) (Agencies "are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.")

[31] Petitioner also argues that the "without recourse" requirement of section 16 limits banks in the form of brokerage services they may provide. Relying on language in *Awotin v. Atlas Exch. Nat'l Bank*, 295 U.S. 209 (1935), to the effect that the term "without recourse" should not be confined to its "technical commercial definition," petitioner claims that banks, in performing brokerage services, must avoid entirely the risk of liability to third-party purchasers or sellers, which, according to petitioner, can only be accomplished if banks pass orders from their customers along to a broker for execution pursuant to an arrangement under which the

The legislative background and history of section 16 also suggests that there is no such limitation. Before 1933, banks were extensively engaged in brokerage activities.[illegible] Indeed, bank brokerage activities were so widespread that Mr. Justice Cardozo, then-Chief Judge of the New York Court of Appeals, took judicial notice of the fact: "In many banks special departments are organized for that very purpose." *Block v. Pennsylvania Exchange Bank*, 170 N.E. 900, 901-02 (N.Y. 1930).[illegible]

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broker looks directly to the customer for performance. (Petitioner's Br. at 31-34.) Petitioner's interpretation is without merit. In *Awotin*, a bank had executed an agreement with a customer *to repurchase certain bonds at their original price, plus interest*, thereby assuming a risk identical or even greater than that it would have assumed if it had made or endorsed an instrument in accordance with the customary definition of "recourse." That the assumption of such a risk does not escape the "without recourse" limitation hardly suggests, as petitioner argues, that that limitation is violated by the mere possibility that a bank could suffer loss if a customer defaulted on a purchase or sale order if the market moved against the customer's position in the short time between the order date and the settlement date, and if the bank could not recover on the claim it would have against its customer. (Petitioner Br. at 31-34). The risk that a customer will not perform his obligations is hardly unique to brokerage services and hardly one that the Glass-Steagall Act could be said to guard against. Indeed, the risk that a bank may lose money because of a customer default at settlement of a brokerage transaction (where the bank has the securities or the proceeds in hand) is less than the risk a bank faces virtually every time it makes a loan to a customer—an activity indisputably permitted to banks. Contrary to petitioner's claim, the reading of the statutory limitation that is most consistent with the purpose of the Glass-Steagall Act is the one adopted by the Board below: a bank trades "without recourse" when—like Schwab, but unlike the bank in *Awotin*—it makes no warranty as to the quality of the investment. (151A.)

[illegible] *See generally* A. Fiske, *The Modern Bank* 154 (1918); L. Langston & N. Whitney, *Banking Practice* 309 (1921); R. Westerfield, *Banking Principles and Practice* 508-09 (1924) (describing customer securities or bond departments).

[illegible] *Accord New York Stock Exchange v. Smith*, 404 F. Supp. at 1098 ("Prior to the passage of the Glass-Steagall Act, banks per-

Banks did not limit provision of these services to their customers; rather, brokerage services were provided to "the public in general." [84] And brokerage services were offered with respect to stock as well as investment securities.[85]

If these activities gave rise to congressional concern, that concern is nowhere evident in the legislative history of the Glass-Steagall Act. To the contrary, in the one clear reference to bank brokerage activity appearing in the entire legislative history preceding passage of the Act, Senator Glass explained that under section 16, "[n]ational banks are to be permitted to purchase and sell investment securities for their customers *to the same*

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chased and sold securities for the accounts of customers . . ."). *See, e.g., Dyer v. Broadway Central Bank*, 169 N.E. 635 (N.Y. 1930); *Matousek v. Bank of Europe Trust Co.*, 255 N.Y.S. 150 (App. Div. 1932); *Brooklyn National Bank v. Keystone Bond & Mortgage Co.*, 268 N.Y.S. 485 (Sup. Ct. 1933); *Le Marchant v. Moore*, 44 N.E. 770 (N.Y. 1896); *Central National Bank v. White*, 34 N.E. 1065 (N.Y. 1893). New York banks were by no means unique. Courts throughout the nation upheld the power of banks to deal in securities as agents. *Klein v. Realty Board Investors*, 192 N.E. 867 (Ohio Ct. App. 1934); *Clucas v. Bank of Montclair*, 166 A. 311 (N.J. 1933); *Citizen's National Bank v. Ratcliff & Lanier*, 253 S.W. 253 (Tex. App. Comm'n 1923). This Court recognized that a national bank had the power to purchase bonds at the request of its customers. *Blakey v. Brinson*, 286 U.S. 254 (1932). *See also Boone v. American Veterinary Medical Ass'n*, 85 F.2d 616 (6th Cir.), *cert. denied*, 298 U.S. 659 (1936); *McNair v. David*, 68 F.2d 935 (5th Cir. 1931), *cert. denied*, 292 U.S. 647 (1934); *Messick v. Rardin*, 6 F. Supp. 200 (E.D. Ill. 1934), *appeal dismissed*, 78 F.2d 643 (7th Cir. 1935); *Mark v. Westlin*, 48 F.2d 609 (D. Minn. 1931).

[84] Smith, *Stock Market Service Comes High*, Am. Bankers A.J. 965 (April 1929); *see Greenfield v. Clarence Sav. Bank*, 5 S.W.2d 708 (Mo. Ct. App. 1928).

[85] *See, e.g., Block v. Pennsylvania Exchange Bank*, 170 N.E. 900, (involving bank's purchase of corporate stock as agent); *Matousek v. Bank of Europe Trust Co.*, 255 N.Y.S. 150 (same).

extent as heretofore."[86] As the Board found (151A), the fact that the voluminous legislative history of the Glass-Steagall Act barely touches upon the scope of permissible brokerage operations reflects that Congress was not concerned with, and thus did not intend to prohibit, such activities.[87]

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[86] S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933) (emphasis added); *see* S. Rep. No. 584, 72d Cong., 1st Sess. 15 (1932) (similar language); H. Rep. No. 150, 73d Cong., 1st Sess. 3 (1933) (similar language).

[87] Petitioner's reliance (Petitioner's Br. at 25-26) on various statements by Thomas Corcoran concerning the proposed exclusion of banks from regulation under the Securities Exchange Act of 1934 is misplaced. Mr. Corcoran was not a member of Congress, and he made clear that he was expressing his personal views only on legislation dealing with the regulatory jurisdiction of the SEC, not the scope of the Glass-Steagall Act. *See Stock Exchange Practices: Hearings on S. Res. 84, 56, & 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 6463 (1934).

To the extent the legislative history of the Securities Exchange Act of 1934 is at all relevant, it in fact suggests that Congress was well aware that banks were extensively involved in providing brokerage services, not that such involvement was, as petitioner claims, "severely limited." (Petitioner's Br. at 27.) In testimony on a version of the bill which did not exclude banks from the definitions of broker and dealer, one banker commented:

> "Your attention is particularly called to the definition of the words 'broker' and 'dealer.' As above explained, *banks are daily engaged 'in effecting transactions in securities for the account of others.'* . . . I assume from other portions of the bill that it is not your purpose to include banks within the definition of brokers or dealers. If this be so, I submit that these definitions should be changed, or that some specific statement should be made that banks are not included in such definition."

Stock Exchange Practices at 7222 (statement of William C. Potter, Chairman of the Board, Guaranty Trust Co.) (emphasis added). At that point, Ferdinand Pecora, counsel to the Committee, responded: "I might just interrupt to say that I think that that assumption is a sound one," *id.*, a response plainly suggesting that the exclusion of banks from provisions of the 1934 Act was based on considerations other than Mr. Corcoran's statements.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals should be affirmed.

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No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

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REPLY BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

I.

RESPONDENTS ATTEMPT TO REWRITE HISTORY

Obviously aware that the actions of regulators and institutions governed by a statute are a good guide to its meaning, respondents attempt to revise both financial and legislative history. Revisionism, however, cannot eliminate fact.

A. Respondents Recant Administrative Construction

The Comptroller clearly understood that banks were not permitted to be public securities brokers. His Office ruled in 1934 that Section 16 of the Glass-Steagall Act "does not mean that national banks may do a brokerage business;" convinced Congress in 1935 to permit banks to pass on their customers' orders for stock because banks could do so only "as an accommodation thereto;" and repeated through ensuing decades that "[s]ervices in this field must be limited to actual customers of the bank—that is, the customer relationship must exist independently of the particular securities transaction."[1] (*See* SIA Br. at 24, 29 n.52.)[2] No amount of semantic sleight of hand can turn this history into a "longstanding administrative practice and interpretation" (BAC Br. at 7) that *permitted* banks to carry on a securities brokerage business for the public.

Equally apparent is the view of the Securities and Exchange Commission ("SEC"), the agency actually responsible for regulating securities activities. The SEC recently found itself compelled to propose a rule requiring banks that "publicly solicit brokerage business" to register as broker-dealers under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* ("1934 Act"). *See* 48 Fed. Reg. 51,930 (1983) (to be codified at

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1 The Board, too, approved of the Comptroller's reading, beginning in 1934. Indeed, the Board expressly quoted from the Comptroller's 1934 ruling in its own ruling that same year. (SIA Br. at 23-24.) Had the Board in any way disagreed with the Comptroller's position, at a minimum, the Board would not have included it then and doubtless would have said so.

2 References to the Brief of Petitioner Securities Industry Association will be cited herein as "SIA Br.;" the Brief of Respondent Bank-America Corporation will be cited as "BAC Br.;" the Brief of the Federal Respondents will be cited as "Fed. R. Br.;" and the Brief of Amici American Bankers Association, et al., will be cited as "ABA Br."

17 C.F.R. pt. 240) (proposed Nov. 15, 1983). The SEC left no doubt that in its opinion banks' recent entry into the brokerage business directly contravenes the Congressional understanding that had led to the exclusion of banks from the definition of "broker" in the 1934 Act:

> Bank brokerage activities and related promotional practices have recently changed significantly from the accommodation functions contemplated by the Congress when it enacted the bank exclusion [in the 1934 Act]. . . . Today, so-called "discount brokerage" is aggressively promoted by many banks. . . . Rather than merely providing accommodation services to existing customers, services are provided [by banks] that are functionally indistinguishable from those offered by registered broker-dealers. . . . The Commission believes that, in enacting the bank exclusion, the Congress did not contemplate that banks would publicly solicit brokerage business. . . .[3]

Despite the obvious relevance of the views of the SEC[4] and the emphasis they received during both the administrative proceedings below and in respondents' briefs here (*e.g.*, BAC Br. at 3, 8; Fed. R. Br. at 27-29), respondents do not include one word of discussion concerning the SEC's proposed rule. Their silence speaks, eloquently, for itself.

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3 48 Fed. Reg. at 51,931. The SEC found highly relevant the Congressional testimony of Thomas G. Corcoran (already cited in SIA Br. at 25-27) in construing the 1934 Act's exclusion of banks. 48 Fed. Reg. at 51,931 n.12. The SEC's view confirms that respondents are misguided in divining that Congress excluded banks from that Act's definition of "broker" because of some other testimony. (Fed. R. Br. at 46 n.43; BAC Br. at 41 n.87.) Respondents' speculation also ignores that Corcoran's testimony related to a change he was urging in a specific provision of the proposed legislation and that Congress adopted his suggestion. (*See* SIA Br. at 27 n.48.)

4 Because securities activities are central to this case, as is the interrelationship between the 1934 Act and the Glass-Steagall Act, the views of the SEC concerning permissible securities activities are entitled to at least as much consideration as those of the Board.

B. Respondents Recast Industry Understanding

Respondents expend considerable effort to explain why, if bank activities "have always involved provision of brokerage services" (BAC Br. at 3), banks had not been in the public brokerage business for nearly 50 years after the Glass-Steagall Act was passed. The actions (or, more precisely, inactions) of the banking industry actually confirm what has been common knowledge for half a century, that banks are barred from the public securities brokerage business. Respondents suggest (*id.*) that banks avoided the public securities business because securities exchanges placed restrictions upon the structure of their members. But, if banks in fact had thought it was permitted, they could have executed orders for the public in both listed and unlisted securities in the over-the-counter market (*see* ABA Br. at 6), which does not require exchange membership.[5]

Respondents' story relies principally, however, upon the alleged precedent of services that banks did offer beginning in the 1970's, as reported by the SEC's 1977 study of bank securities activities.[6] (BAC Br. at 3, 8; Fed. R. Br. at 27-29.) In

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5 Although banks having the proper business structure could, and a few did, retain seats even on the New York Stock Exchange (Fed. R. Br. at 36 n.33), there is no evidence that such banks engaged in the public securities brokerage business after the Glass-Steagall Act was passed.

6 Securities and Exchange Commission, *Initial Report on Bank Securities Activities* (1977) ("*SEC Initial Report*"); Securities and Exchange Commission, *Final Report on Bank Securities Activities* (1977) ("*SEC Final Report*"). Both reports are reprinted in *Reports on Banks' Securities Activities of the SEC*, Senate Comm. on Banking, Housing and Urban Affairs, 95th Cong., 1st Sess. 1, 289 (Comm. Print 1977). These SEC Reports, marked as BAC Exhibits 53 and 54, were virtually the only historical evidence of bank securities activities introduced during the hearing in this case before the Administrative Law Judge, who also relied heavily upon them. *E.g.*, 25A-32A; 74A. Thus, the "facts" found in this respect are simply derivative of the SEC's study.

fact, the SEC study showed that banks still limited their activities either to the accommodation services traditionally offered to their banking customers[7] or to other services largely ministerial in nature, offered by a *de minimis* number of banks,[8] in each of which the banks continued to forward customer orders to brokers for execution.[9] As the SEC pointed out in its recent proposed rulemaking, "[c]urrent bank securities activities . . . differ significantly from those reviewed by

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7 The term applied by the SEC in its 1977 study in this respect was "[c]ustomer transaction service" (*SEC Final Report* at 20 n.40), which it found to be "a distinctly informal service provided as an accommodation to bank customers. As an accommodation, it is not marketed to bank customers, is rarely mentioned in bank literature, and, viewed separately, is uniformly unprofitable to the bank." *SEC Initial Report* at 78.

8 These services included automatic investment services, dividend reinvestment plans and employee stock purchase plans, which were "offered pursuant to specific terms and conditions, are highly automated, limit the amount of securities that can be purchased, involve pooling investors' funds for investment, and generally involve little or no personal contact with participants." *SEC Final Report* at 34 n.63. In the aggregate, the services accounted for less than two-tenths of one percent of all retail securities traded on national stock exchanges. *SEC Initial Report* at 13.

9 Reaching to find any support for their position, respondents also cite (Fed. R. Br. at 28-29; BAC Br. at 13-14) bank trust department activities. But, for example, the SEC found that, at 98% of bank trust departments, "[r]elatively little trading expertise was required of such [trading desk] personnel, since the trader simply relied upon the broker to supply whatever expertise was necessary to obtain 'best execution.' " (*SEC Final Report* at 166 & n.274.) Again, the SEC found that at more than 99% of bank trust departments, "traders had not received any formal training in either securities markets or the securities laws" and at many banks "a telephone without direct lines is typically the only communications facility." (*Id.* at 176-77.) Only 17 of the 4,022 commercial bank trust departments (*i.e.*, 4/10 of 1%) used electronic services to effect a transaction with another institutional investor. (*Id.* at 166 n.274, 178.)

the Commission in its 1977 study of bank securities activities."[10]

The specific activity now at issue, respondents agree, is "the business of executing orders to buy and sell securities" for the public. (Fed. R. Br. at 27.) There is simply no dispute that banks had not engaged in this business for the past 50 years.[11] It bears reiteration that, in this proceeding of admitted "first impression" (*see* SIA Br. at 4 n.4), the Board itself rejected as inapplicable the Bank Holding Company Act criterion that "banks generally have in fact provided the proposed services" (*see* SIA Br. at 17 n.29), and acknowledged that this case involves the "[e]xpansion of banking into securities activities." (155A.)

C. Respondents Reconstruct Legislative History

1. *The Bank Holding Company Act.* Respondents claim that, in 1970, Congress amended the Bank Holding Company Act to eliminate the "direct and significant connection" requirement that had previously applied under that Act (*see* SIA Br. at 13-14) and gave the Board flexibility to adopt the "functionally similar" test applied here. (Fed. R. Br. at 17-21; BAC Br. at 19-21.) The legislative history proves the opposite.

Insofar as relevant here, the Board in 1970 had urged Congress (1) to substitute its "functionally related" test for the statute's "so closely related" standard and (2) to delete the

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10 48 Fed. Reg. at 51,931. The SEC's release also confirmed that its 1977 study had found that the brokerage activities then being conducted by banks "differed from the activities of broker-dealers in several important respects, such as the informal nature of the services rendered, the general absence of advertising for customer transaction services, and the general absence of commissions based on the size of transactions." 48 Fed. Reg. at 51,931 n.9.

11 Nor can respondents avoid the issue by claiming that discount brokerage is a "new form of brokerage activity." (Fed. R. Br. at 48.) "Discount" brokerage is agency brokerage, which has existed for decades, merely offered at a different commission rate.

phrase "the business of" from the statutory provision requiring that proposed activities be "closely related to the business of banking." (*See* SIA Br. at 14.) The compromise reached by the Conference Committee on the Board's proposal was to accept the latter deletion but to refuse the former. The result was that:

> Under the new language of section 4(c)(8) there no longer need be a relationship between the particular activities of the company proposed to be acquired and the business of the particular bank holding company seeking approval of an acquisition under section 4(c)(8). In other words, *under the new section 4(c)(8) there must be a direct and significant connection between the proposed activities and the kinds of activities that banks generally now carry on, i.e., closely related to banking in general.*[12]

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12 H.R. Conf. Rep. 1747, 91st Cong., 2d Sess. 5, *reprinted in* 1970 U.S. Code Cong. & Ad. News 5561, 5572 (emphasis added). Whatever other controversy there may have been about the Conference Committee's actions (*see ICI* II, 450 U.S. at 73-74 n.54), there appears to have been basic agreement in Congress on the point covered by the above-quoted language, as indicated by statements during the House and Senate debates from the respective floor managers of the compromise bill. Representative Patman stated:

> Under the new section 4(c)(8) there must be a direct and significant connection between the proposed activities and the kinds of activities that banks generally now carry on; that is, closely related to banking in general. However, with the deletion of the words "the business of," there no longer need be a relationship between the particular activities of the company purposed [sic] to be acquired [and] the business of the particular bank holding company seeking approval of an acquisition under section 4(c)(8).

116 Cong. Rec. 41,950 (1970). Senator Sparkman stated:

> [The Bill] frees the Board of the restrictive precedents established under the present act and it provides that permissible activities may be related to the business of banking generally, rather than perpetuating the concept that such activities must be related to the specific business carried on by the subsidiary banks of the particular holding company involved.

116 Cong. Rec. 42,424 (1970).

Thus, to the extent the 1970 Amendments to Section 4(c)(8) gave the Board greater flexibility, it was only insofar as a "direct and significant connection" was no longer required between proposed activities and those of the specific applicant holding company. (SIA Br. at 14 n.22.) A "direct and significant connection" *is* required between a proposed activity not generally performed by banks and the activities of banking in general. That is the issue here, and that is precisely the connection the Board did not—and could not—find. (SIA Br. at 15.)

It is no mere "fortuity" (Fed. R. Br. at 20) that the Board used almost exactly the same "functional" language here as it had unsuccessfully urged upon Congress.[13] The Board has attempted to amend the Act in the fashion Congress refused to accept. Having lost that debate before Congress, the Board now seeks reargument before this Court. It should be denied.

2. *The Glass-Steagall Act.* Citing language in the Congressional Reports that "national banks are to be permitted" to purchase and sell securities for their customers "to the same extent as heretofore," respondents claim that Section 16 of the Glass-Steagall Act expressly authorized banks to engage in the public brokerage of both stock and securities. (Fed. R. Br. at 43-44; BAC Br. 40-41, citing S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933).) Banks, however, had never theretofore statu-

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13 If anything, the "functionally similar" test here applied by the Board is even broader than the "functionally related" test proposed in 1970. At least "functionally related" connoted some kind of a functional or operational connection with banking; whereas, the present similarity test requires no connection whatsoever. Indeed, the Board's "functionally similar" construction becomes patently unreasonable when applied to the full language of Section 4(c)(8), which requires proposed activities "to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." Countless activities arguably are "functionally similar" to "managing or controlling" banks. If that were the standard, the limitation would be meaningless. (*See also* SIA Br. at 18-19.)

torily been "permitted" to purchase and sell *stock* for the public. The McFadden Act of 1927 had authorized banks only to deal in *investment securities* (*i.e.*, high quality debt instruments; *see* SIA Br. at 21 n.36), and courts had repeatedly made clear that conducting a brokerage business in stock or other speculative securities for the public was prohibited for banks.[14] The only permissible activity for banks involving *stock* had been accommodation of their customers, as an incident to banking services.[15]

It was precisely because the Comptroller understood that the exception for "purchasing and selling" investment securities included in the 1933 Glass-Steagall Act was limited to accommodating orders from bank customers that he urged Congress in 1934 to clarify its intent not to restrict banks' incidental authority to accommodate orders in stock as well. He repeatedly explained to Congress that the authority would apply

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14 As late as 1933, the New Jersey Court of Appeals, collecting earlier cases and authorities, held that "a national bank may neither directly for its own account, nor as agent for a customer, legally enter into a contract to purchase speculative securities. . . ." *Cassatt* v. *First National Bank*, 111 N.J.L. 536, 168 A. 585, 588 (Ct. App. 1933), *cert. denied*, 291 U.S. 660 (1934). *See also Pepperday* v. *Citizen's Bank of Latrobe*, 183 Pa. 519, 38 A. 1030, 1031 (1898) ("[i]t is no part of the business of a national bank to engage in the selling of stock for anybody").

15 Perhaps the clearest indication of the general understanding in this respect prior to 1933 was set forth in *Block* v. *Pennsylvania Exchange Bank*, 253 N.Y. 227, 170 N.E. 900 (1930). There Justice Cardozo, then Chief Judge of the New York Court of Appeals—a court that regularly dealt with commercial matters—noted: "[T]he practice of banking as it has developed in our day upholds the purchase of securities for the benefit of *customers whose deposit accounts are sufficient, as the result of loans or otherwise*, to justify the credit." 253 N.Y. at 232, 170 N.E. at 901-02 (emphasis added). The other authorities cited by respondents (Fed. R. Br. at 44; BAC Br. at 40) are not to the contrary; none shows that banks brokered stock for the public, while they do confirm that banks generally acted only to accommodate unsolicited securities orders from their customers by forwarding the orders to brokers for execution.

only to accommodating bank customers, and plainly Congress understood that when it amended Section 16 in 1935. (*See* SIA Br. at 22-25.) As respondents concede (BAC Br. at 37 & n.78), that amendment was regarded as "technical" and not intended to make any "fundamental changes in the existing banking laws." *See* H.R. Rep. No. 742, 74th Cong., 1st Sess. 1-2 (1935). Yet they would have this Court conclude that in 1935, through a technical, nonsubstantive amendment to a statute that broadly barred banks from securities activities, Congress for the only time in two centuries expressly authorized banks to execute *stock* transactions for the public.

Preposterous on its face, this conclusion would also write the "without recourse" restriction out of the statute. Respondents' only response to this restriction is to claim that SIA must somehow be wrong in its analysis (SIA Br. at 31-34) that "without recourse" requires banks to forward customers' orders to brokers for execution. (Fed. R. Br. at 49-50; BAC Br. at 38 n.81.) They offer no explanation of what "without recourse" does mean in a brokerage context, citing instead only the Board's interpretation of the phrase as meaning without endorsement or guarantee. (150-51A n.50.) But, that interpretation can have no application to stock brokerage and has already been rejected by this Court. (*See* SIA Br. at 31-33.) Respondents simply have no answer.[16]

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16 Respondents' *amici*, citing the Restatement (Second) of Agency §§ 321, 322 (1958), suggest that banks cannot avoid the risk of liability to third-party purchasers and sellers, because banks are agents for undisclosed principals. (ABA Br. at 10-11.) This contention reflects an apparent lack of knowledge of the securities industry in general and the record in this case in particular. As the record shows (J.A. 249-57; Record on Appeal at R.2590-98 (Jannotta testimony at 3-11)), many securities firms act as "introducing" brokers and forward their customers' securities orders to a correspondent firm for execution. Some firms do this through a single "omnibus" account maintained in the name of the introducing broker; others "give up" the names of their customers to the correspondent firm, under what is commonly referred to as a "fully disclosed" arrangement. The forwarding broker thereby avoids the obligation of having to carry the customers' accounts; confirmations and account statements are sent directly to the cus-

Equally absent from respondents' briefs is any explanation of why Congress would have permitted bank affiliates to do principally under Section 20 of the Act what Congress barred entirely to banks themselves under Section 16. (*See* SIA Br. at 41-42.) Nor do respondents present any support for the Second Circuit's unprecedented decision vesting the Board with discretion, withheld by Congress in the Glass-Steagall Act, to decide which activities barred entirely to banks may nevertheless be performed principally by their affiliates. (*Id.*) The reason for this absence of support is also clear. There is none.

Respondents argue that the term "public sale" in Section 20 refers only to operations involving the marketing of new issues or the introduction of blocks of securities to the public.[17] (Fed. R. Br. at 31-32; BAC Br. at 25-27.) But, if that were so, the term would be redundant to the accompanying terms "underwriting" and "floating", contrary to the settled rule of statutory construction that all terms should be accorded a meaning.[18] Equally unavailing is respondents' observation (Fed. R. Br. at 31; BAC Br. at 26-27) that Section 20 does not

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tomers. (In recognition of this, the SEC exempts from its normal net capital requirement introducing brokers who forward accounts solely on a "fully disclosed" basis. 15 C.F.R. § 240.15c3-1(a)(2)(i).) A bank similarly can pass along its customers' orders to a broker for execution, pursuant to a "fully disclosed" arrangement under which the broker looks directly to the customer for performance. There is thus no "undisclosed principal" and, as required by the Glass-Steagall Act, "recourse" against the bank is avoided.

17 Significantly, respondents abandon the principal rationale articulated by the Second Circuit for holding that the term "public sale" in Section 20 is inapplicable to brokerage—that the terms in the section apply only to principal activity, and therefore are inapplicable to agency brokerage. (161A; *see* SIA Br. at 38-39.)

18 *E.g.*, *Colautti* v. *Franklin*, 439 U.S. 379, 392 (1979). The broad reach of the activities described in Section 20 ("issue, flotation, underwriting, public sale, or distribution") indicates that Congress intended not to be redundant, but rather to cover the entire spectrum of securities transactions, both principal and agency, just as the breadth of the instruments described in Section 20 ("stocks, bonds,

use the term "brokerage" or the "more precise" (162A) terms found in Section 16. Narrower terminology should be expected in Section 16, because Congress there drew a very narrow exception to the otherwise broad prohibition against banks' dealing in securities. In Section 20, however, Congress legislated a broad prohibition, and correspondingly broad terms should be expected.[19] Those terms prohibit the activity here at issue.

II.

ONLY CONGRESS MAY PROPERLY ACCOMPLISH THE POLICY CHANGE MADE BY THE BOARD

Ironically, testifying on April 4, 1984 during a Congressional hearing on legislation concerning restructuring of the financial service industries, Board Chairman Volcker, who voted in favor of the Schwab acquisition, stressed that "[w]e have a [financial] system that is changing, helter skelter, in response to

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debentures, notes, or other securities") indicates Congress' intent to cover the entire range of securities, both equity and debt. *See ICI* I, 401 U.S. 617, 635 (1971).

19 Congress did not use the generic term "brokerage" in Section 16 either, but rather used the more specific phrase "purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers"—underscoring Congressional intent to limit banks solely to forwarding orders from their banking customers to brokers for execution. Nor, contrary to respondents' arguments (Fed. R. Br. at 40 n.38; BAC Br. at 33 n.71), do any "unreasonable results" flow from Congress' omission from Section 20 of the Section 16 exception. The exception was necessary in Section 16 because otherwise banks would have been entirely prohibited even from forwarding orders to brokers as an accommodation incidental to other banking services. It would be anomalous if Section 20 also included such a provision. Section 20 permitted bank affiliates to engage in public securities brokerage, so long as it was not their principal activity. No reason existed to include the accommodation language of Section 16 in addition because, as the federal respondents put it, "affiliates of banks have no preexisting customers of banking services." (Fed. R. Br. at 40 n.38.)

a variety of economic and other forces, but with little sense of the public policy issues at stake." And, as he further put it in urging Congress to assert its authority in the financial services field, "[d]eregulation by fiat, by exploitation of loopholes, and by diverse actions taken by individual states is hardly an appropriate response, and threatens to undermine and render ineffective federal oversight of banking."[20]

The delicately balanced regulatory structure built by Congress to govern the financial service industries is beginning to crack apart—impelled to no little degree by the acquisition at issue, as even BAC in effect admits. (BAC Br. at 6; *see also* SIA Br. at 4-5.) If the established boundaries between the industries are to be eradicated, that policy decision should be legislated by Congress, because only it can weigh all the considerations involved. (*See* SIA Br. 44-46.) It should not be dictated, as here, by administrators through *ad hoc* rulings that erode long-standing legislative limits.

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20 Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce United States House of Representatives at 3, 4 (April 4, 1984). On that same day Representative Wirth, Chairman of that Subcommittee, introduced legislation to impose a moratorium on the expansion of activities by all financial services institutions, pending a detailed study of the capital markets by a Congressionally appointed commission. H.R. 5342, 98th Cong., 2d Sess. (1984).

CONCLUSION

For each and all the reasons set forth above and in SIA's initial brief, the decision of the Court of Appeals should be reversed, and the case remanded with directions to vacate the Board's Order of January 7, 1983 as null and void and to direct respondent BAC to divest itself of Schwab.

Dated: April 17, 1984

Respectfully submitted,

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No. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION, THE CALIFORNIA BANKERS CLEARING HOUSE ASSOCIATION, UNION PLANTERS NATIONAL BANK AND SECURITY PACIFIC NATIONAL BANK AS AMICI CURIAE

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April 5, 1984

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INTEREST OF AMICI CURIAE

The American Bankers Association is the national organization of banking, numbering within its membership some

13,600 commercial banks or approximately 91 percent of all such banks in the United States. The New York Clearing House Association (the "Clearing House") is an association of 12 leading commercial banks located in New York City.[1] It operates electronic payment systems and clears commercial drafts and items in the New York area. The Clearing House appeared as amicus curiae before the Court of Appeals for the Second Circuit in this action, *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 716 F.2d 92 (2d Cir. 1983), *cert. granted*, 52 U.S.L.W. 3550 (Jan. 23, 1984). The California Bankers Clearing House Association (the "California Clearing House") is an association of ten major commercial banks that are located in California.[2] It clears commercial drafts and items in that state. Union Planters National Bank and Security Pacific National Bank are national banking associations located in Tennessee and California respectively. We submit this brief in support of respondents, urging affirmance of the decision below.

All parties to this brief have a direct and vital interest in the proper interpretation of Federal banking statutes such as the Glass-Steagall Act and the Bank Holding Company Act. We believe that the Court of Appeals correctly interpreted the Glass-Steagall Act to find that commercial banks and their affiliates may conduct a securities brokerage business, and correctly held that the Board properly exercised its authority under the Bank Holding Company Act in permitting Bank-

[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA and European American Bank & Trust Company.

[2] The members of the California Clearing House are Bank of America, N.T. & S.A., California Canadian Bank, City National Bank, Crocker National Bank, First Interstate Bank of California, Lloyds Bank of California, Security Pacific National Bank, The Bank of California, N.A., Union Bank and Wells Fargo Bank, N.A.

America Corporation ("BAC"), a bank holding company and parent of Bank of America, N.T. & S.A., to acquire Charles Schwab & Co., Inc. ("Schwab"), a discount securities broker. We further believe that the views presented in this brief will significantly aid the Court in its consideration of the issues raised by this action.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Securities Industry Association (SIA) seeks to invoke the Glass-Steagall Act, Pub. L. No. 66, 48 Stat. 162 (1933), and the Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.*, to protect its members from the enhanced competition resulting from the acquisition of a discount brokerage firm by a bank holding company. As we show below, however, neither statute was designed to shelter the securities industry from competition or to preclude bank holding companies from engaging in the brokerage business. On the contrary, § 16 of the Glass-Steagall Act, 12 U.S.C. § 24 (Seventh) (1982), expressly authorizes commercial banks to purchase and sell securities upon the order and for the account of customers. This explicit statutory authority and the long-standing practice of banks in providing brokerage services also demonstrate that brokerage activities are "so closely related to banking . . . as to be a proper incident thereto" within the meaning of § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982).

ARGUMENT

I

THE GLASS-STEAGALL ACT AUTHORIZES COMMERCIAL BANKS TO CONDUCT A BROKERAGE BUSINESS.

A principal objective of the Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162 (1933), commonly known as the Glass-Steagall Act, was to separate certain aspects of the business of investment banking, specifically the underwriting of certain

securities issues, from the business of commercial banking. *Board of Governors of the Federal Reserve System v. Investment Company Institute,* 450 U.S. 46 (1981). To that end, §§ 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh), 378 (1982), restrict the power of commercial banks to underwrite certain securities, while § 20 of the Act, *id.* § 377, prohibits affiliation between commercial banks and firms principally engaged in underwriting and certain related activities.

Notwithstanding these restrictions, the Glass-Steagall Act was not designed to effect a total prohibition on commercial banks' participation in securities activities or to insulate the securities industry from competition with commercial banks. On the contrary, under the Act, banks retained power to engage in a variety of securities-related activities. For example, under § 16 of the Act, banks may buy and sell "investment securities" for their own account and may underwrite government, municipal and certain other securities. 12 U.S.C. § 24 (Seventh) (1982). In addition, as we show below, § 16 of the Act expressly permits banks to conduct a brokerage business. As we also show, § 20 of the Act does not withdraw from bank affiliates the brokerage powers that § 16 explicitly confers on banks themselves.

A. Section 16 of the Glass-Steagall Act Authorizes Commercial Banks To Conduct a Brokerage Business, and They Have Done So for Decades.

Section 16 of the Glass-Steagall Act provides in pertinent part:

> "The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account. . . ." 12 U.S.C. § 24 (Seventh) (1982).

This provision, which applies to state member banks as well as to national banks, *see* 12 U.S.C. § 335 (1982), *expressly authorizes* banks to conduct a brokerage business. "Purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers" is precisely

the business of a securities broker. A broker receives orders for securities transactions from customers and executes them on exchanges or with dealers, acting as an agent, without indemnifying its customers against investment risk or loss.[3] In this respect, we submit that the language of the statute is dispositive.

SIA's principal objection to this straightforward reading of the statutory language is an assertion that "no bank or bank holding company had engaged in the securities brokerage business since the passage of the Glass-Steagall Act half a century ago". SIA Br. at 4. This assertion, however, is mistaken. Banks have long engaged in brokerage and related activities, and they have in fact executed securities transactions in precisely the same manner as other brokers do.

First, it is a matter of common knowledge that banks routinely perform many of the functions performed by securities brokers. For example, banks traditionally have provided custodial and record keeping services for investors, have acted as advisers in financial and investment matters and have exercised decision-making power with respect to investments they manage. As this Court noted in *Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 55, the traditional fiduciary functions of banks include managing securities portfolios of investors, an activity banks have pursued "for decades". As the Court also recognized, "[a]s executor, trustee, or managing agent of funds

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[3] A 1936 SEC report describes the activities of a broker in terms remarkably similar to those employed in § 16, thus indicating that the statutory language would have been understood to refer to brokerage when the Act was passed. The report states:

> "[A] broker employed to execute an order for the purchase or sale of securities is the agent of his customer. He does not undertake to sell to or buy from his customer but rather to negotiate a contract of purchase or sale between the customer and a third party. The transaction is solely for the account of the customer who becomes the owner of securities purchased by the broker on his behalf, is entitled to the profits realized and is liable for the losses incurred." SEC, *Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker,* xiv (1936) (hereinafter "*Broker/Dealer Report*").

committed to its custody, *a bank regularly buys and sells securities* for its customers". *Id.* (emphasis added).

Further, and contrary to SIA's assertion (SIA Br. at 9, 15), in buying and selling securities banks have not merely acted as order takers, referring investors' orders to unaffiliated brokerage firms for execution, but have in fact executed such transactions directly.[4] Banks have long executed orders for over-the-counter securities, *i.e.*, securities which are not listed and traded on stock exchanges, without the aid of an intervening broker. *See* R. Westerfield, *Banking Principles and Practice* 1021 (1921). The SEC, in a special study of the securities markets conducted in 1963, reported that many commercial banks execute orders for unlisted securities (and for those listed securities that are traded over the counter) directly with market makers. SEC, *Report of Special Study of Securities Markets,* H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 at 861 (1963). In a more recent study, the SEC found that "to a significant degree banks effect securities transactions without using brokers at all". SEC, *Reports on Banks Securities Activities,* 95th Cong., 1st Sess., at 422 (1977).

Although brokerage commission and exchange membership rules severely impeded the ability of banks to execute orders for listed securities[5], several of the major private banks —which were organized as partnerships and were therefore

[4] SIA's insistence on the employment of unaffiliated brokers as intermediaries in bank securities transactions amply demonstrates the anticompetitive thrust of this litigation. SIA does not seriously dispute that banks and their affiliates generally have the expertise to engage in securities transactions without the use of such intermediaries. In insisting on their use, SIA seeks only to protect its members' commission income through a form of featherbedding.

[5] In the past, rules of the stock exchanges fixed the commissions that could be charged by brokers who were exchange members, *see, e.g.*, Former NYSE Rule 383; SEC, *Report of Special Study of the Securities Markets,* H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2 at 295 (1963), and, by forbidding exchange membership to corporations, *see* 2 L. Loss, *Securities Regulation* 1172 n. 8 (2d ed. 1961), they also effectively barred most banks from exchange membership.

Because banks were thus compelled to execute transactions in listed securities through exchange members who charged fixed com-

eligible for stock exchange membership—did in fact own seats on the exchange and executed securities transactions there directly. The most notable example is J. P. Morgan & Co. Long recognized as a premier investment banking house, the Morgan firm had also maintained a substantial commercial banking business prior to the Glass-Steagall Act. When the Act became law, the Morgan firm, like many others, found it necessary to choose between its investment banking business and its commercial banking business. Unlike most other such firms, the Morgan firm elected to continue its commercial banking business and to divest its investment banking business. Strikingly, however, the firm did not relinquish its seat on the New York Stock Exchange at the time of divestiture. Instead, it retained that seat and continued to use it for execution of securities transactions for investors' accounts. N.Y. Times, June 9, 1934, at 21, col. 3.[6] In so doing, the firm unquestion-

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missions, they could not offer brokerage services for such securities at a favorable price, and they therefore did not aggressively promote their brokerage services.

Banks did begin to expand their brokerage operations following the deregulation of brokerage commissions, which became fully effective in 1975, *see* Securities Act Amendments of 1975, 15 U.S.C. § 78f(e)(1) (1982) ("no national security exchange may impose any schedule or fix rates of commissions . . . or other fees to be charged by its members . . . ."), and they have offered an increasing variety of brokerage and related services since then. *See generally,* Clark & Saunders, *Glass-Steagall Revised: The Impact on Banks, Capital Markets, and the Small Investor,* 97 Banking L. J. 811, 829-31 (1980); Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services,* 81 Mich. L. Rev. 1498 (1983).

[6] The Morgan firm ultimately relinquished its exchange membership in 1940, when it reorganized as a corporation and thus became ineligible for exchange membership under the stock exchange rules discussed above. Wall St. J., Feb. 17, 1940, at 2, col. 1.

Other private commercial banking firms which maintained stock exchange seats after the Act became law include Laidlaw & Co., A. Iselin & Co., Robert Winthrop & Co. and Brown Brothers, Harriman & Co. *See* N.Y. Times, June 16, 1934, at 21, col. 8. The Brown Brothers firm has maintained its exchange seat continuously to the present. *See* 1 *Moody's Bank and Finance Manual* 1672 (1983) (Brown Brothers "[c]onducts a general domestic and foreign banking business and acts as brokers for purchase and sale of securities").

ably relied upon § 16 of the Act—and was never challenged in that interpretation even though its continuation of its brokerage business was widely publicized at the time. *See id.; see also* N.Y. Times, June 1, 1934, at 1, col. 1; N.Y. Times, June 8, 1934, at 31, col. 8.

Finally, the Federal Reserve Board, in an interpretation of the Glass-Steagall Act that remains unaltered to this day, expressly authorized state-chartered member banks to continue their brokerage business while engaging in the business of commercial banking. The Board ruled that the limitations set forth in § 16 of the Glass-Steagall Act were "not to be regarded as affecting dealings in corporate stock by banks", and concluded "there is no prohibition in the Federal statutes against State member banks buying or selling shares of corporate stock solely upon the order and for the account of customers". 20 Fed. Res. Bull. 609 (1934).

In short, petitioner ignores the historical record of commercial bank involvement in the brokerage business. Both before and after the Act was passed, banks in fact purchased and sold securities for investors.

Against this clear statutory language and the historical record, SIA raises three additional objections. First, it asserts that restrictive interpretations placed upon § 16 of the Act by the Comptroller of the Currency in the mid-1930s limit banks' brokerage activities to certain "accommodation" services. SIA Br. at 20-31. Second, SIA argues that commercial banks conducting a brokerage business will necessarily violate the requirement of § 16 that banks purchase and sell securities "without recourse". SIA Br. at 31-34. Third, it contends that the term "customers" as employed in § 16 refers only to persons who have a prior banking relationship with the particular bank, so that banks may not offer brokerage services to the general public. SIA Br. at 21-25, 28-30. The Court of Appeals correctly found none of these remaining arguments to be persuasive.

1. *Bank Brokerage Activities Are Not Limited to "Accommodation Services".*

SIA argues that the Board of Governors, and this Court, are bound by a restrictive interpretation of § 16 made by the Comptroller of the Currency in the mid-1930's limiting bank brokerage activities to "accommodation services" for customers. More recently, however, the Office of the Comptroller has reconsidered these early rulings, and has found that § 16 raises no bar to a national bank seeking to establish a discount brokerage subsidiary. *See Security Pacific National Bank,* [1982-83 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284 (Comptroller of Currency 1982), *aff'd in pertinent part sub nom. Securities Industry Association v. Comptroller of the Currency,* 577 F. Supp. 252 (D.D.C. 1983), *cross-appeals pending,* Nos. 84-5026 *and* 84-5085 (D.C. Cir. 1984). In so doing, the Comptroller determined that "the early interpretations contained restrictions not imposed by the statute", *id.,* and reflected " 'the great caution of banking regulations in the years immediately following the 1931-2 debacle' ". *Id., quoting* Letter from Comptroller of Currency to G. Duane Vieth (June 10, 1974), [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

The Comptroller's rejection of the early restrictive interpretation placed on § 16 by his predecessors represents not an unprincipled about-face as SIA contends, but the culmination of a gradual reassessment of those early views. As early as 1957, the Comptroller reversed his earlier ruling to the extent of determining that banks executing orders to buy or sell securities for customers were permitted to make a profit for their services. Comptroller of the Currency, Digest of Opinions, ¶ 220A (1957); *see New York Stock Exchange, Inc. v. Smith,* 440 F. Supp. 1091, 1097 (D.D.C. 1975), *vacated as not ripe for review sub nom. New York Stock Exchange, Inc. v. Bloom,* 562 F.2d 736 (D.C. Cir. 1977), *cert. denied sub nom. New York Stock Exchange, Inc. v. Heimann,* 435 U.S. 942 (1978). Similarly, in a 1974 ruling, the Comptroller rejected the view that the purchase and sale of securities could only be performed as an "accommodation" to customers:

"This [earlier] view, like many others expressed by bank regulators, in the immediate post-depression decades, was designed to be ultra-conservative and to confine banks as narrowly as possible in their activities. However, in this regard, the office apparently went further in the direction of conservatism than did the Congress, since neither the word nor the idea of the 'accommodation' limitation appears in the statute or in any committee or floor comments."

Letter from Comptroller of Currency to G. Duane Vieth (June 10, 1974), [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272.

Reviewing courts have found the Comptroller's more recent interpretation of the Glass-Steagall Act "both reasonable and correct as a matter of law", *New York Stock Exchange, Inc. v. Smith, supra,* 404 F. Supp. at 1101, and fully justified by the legislative history of the Act, *Securities Industry Association v. Comptroller of the Currency, supra,* 577 F.Supp at 255. In this action, the Court of Appeals "agree[d] with the Comptroller that the Act's policies are not contravened by bank participation in retail brokerage" and accorded "significant weight to the Comptroller's repudiation of his earlier rulings". *Securities Industry Association v. Board of Governors of the Federal Reserve System, supra,* 716 F.2d at 99. We submit that, as the courts have recognized, a ruling made some fifty years ago and long since rejected provides no basis to disregard the well-reasoned views of the Comptroller as presently expressed.

2. *The Meaning of "Without Recourse".*

SIA asserts that the "without recourse" limitation contained in § 16, as interpreted by this Court in *Awotin v. Atlas Exchange National Bank,* 295 U.S. 209 (1935), prevents banks from acting as brokers. Specifically, SIA asserts that the "risk [of] liability to third-party purchasers or sellers" arising in brokerage transactions constitutes a form of "recourse" prohibited by the statute as interpreted in *Awotin.* SIA Br. at 32. This contention is without merit.

First, the risk of incidental liability to third parties in the case of customer default is simply not the sort of risk with which the "without recourse" limitation is concerned. In *Awotin,* this Court held that that limitation prohibits banks from assuming the "contingent liability" that could arise under a "contract by which the bank assumes *the risk of loss which would otherwise fall on the buyer of securities". Awotin v. Atlas Exchange National Bank, supra,* 295 U.S. at 211-12 (emphasis added). As this Court made perfectly plain, the "risk" at which the limitation is aimed is the *investment risk* associated with the purchase of securities. In other words, under the "without recourse" limitation, banks cannot undertake to indemnify investors against the risk of loss associated with the investments they have made. The risk that the customer may default on the transaction is entirely different from the investment risk associated with a given security, and is thus completely irrelevant to the "without recourse" limitation.

Second, SIA's argument simply falls of its own weight. As a broker must look to his customer for payment in the event of default, so an intervening broker employed by a bank to execute transactions would look to the *bank* for payment in the event of default—and the bank, as agent for an undisclosed principal (its customer), would be liable for the transaction. *See* Restatement (Second) of Agency §§ 321, 322 (1958). Employment of an intervening broker merely moves the bank one additional step away from the party on the other side of the transaction—but it does not affect the risk that the bank will be held liable for its customer's default. Accordingly, if the incidental risk of liability to third parties arising from customer default were the sort of risk with which the "without recourse" limitation were concerned, then banks could *never* become involved in securities transactions even to the extent of forwarding orders to brokers for execution, for the broker would always have such "recourse" against the bank as its customer's agent. As a matter of statutory construction and common sense, the "without recourse" limitation cannot have been intended by Congress to swallow up authority otherwise granted by the statute

Finally, since the day the Glass-Steagall Act was passed, banks have consistently assumed the risk associated with customer default. As discussed above, since the enactment of the statute, banks have executed securities transactions both with and without the aid of intervening brokers. In each and every such transaction, the bank serving as broker has assumed, of necessity, the risk which SIA views with such alarm. So far as we are aware, it has never been suggested that the necessary assumption of that risk violates the Glass-Steagall Act. On the contrary, since 1934, federal banking regulators have implicitly approved banks' assumption of that risk by their endorsement of commercial bank brokerage activity. *See, e.g.*, 20 Fed. Res. Bull. 609 (1934). Banks have assumed that risk—and have been permitted by banking authorities to do so—for the simple reason that the statute is concerned only with assumption of investment risk, and has nothing whatever to do with the risk of customer default incidental to any securities transaction.

3. *The Meaning of "Customers".*

SIA suggests that the term "customers" as employed in § 16 permits a bank to offer brokerage services only to persons with whom it has a prior banking relationship, not to the general public. SIA Br. at 21-25, 28-30.[7] This reading, which

[7] In arguing that banks may provide brokerage services only to pre-existing banking customers, SIA relies in part upon § 3(a)(4) of the Securities Exchange Act of 1934 (the "1934 Act") which defines "broker" to mean "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank". SIA Br. at 21-22, *citing* 15 U.S.C. § 78c(a)(4) (1982). From the use of the term "others" in the 1934 Act, as opposed to "customers" in the Glass-Steagall Act, SIA concludes that the Glass-Steagall Congress intended to restrict bank brokerage activities to existing bank customers. As is clear from the language of the 1934 Act provision, however, Congress believed that banks *would* be covered under the 1934 Act as persons "engaged in the business of effecting transactions in securities for the account of others" *unless they were explicitly excluded.* Thus, to the extent that the 1934 Act is relevant, it actually shows that Congress thought banks performed exactly the same transactional function as ordinary brokers.

had been adopted by the Comptroller of the Currency in the early interpretations he has since rejected, *see* pp. 9-10, *supra*, gives the statutory language an emphasis and complexity of meaning that it simply does not have.

The purpose of the Glass-Steagall Act was to limit banks' ability to engage in underwriting. Given that purpose, the reference to purchases and sales "for the account of customers" obviously serves only to distinguish such agency transactions, which do not constitute underwriting or dealing and are permitted, from transactions made "for [the bank's] own account", which may constitute underwriting or dealing and are limited.[8] Neither the language of the statute nor the regulations promulgated thereunder require bank brokerage "customers" to be persons with a preexisting banking relationship with the particular bank.[9] A customer for bank brokerage services is no less a "customer" of the bank because he deals otherwise with other banks.

In addition, SIA's reading of the statute would raise a number of difficult definitional problems that Congress could be expected to have addressed if it had intended the term

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[8] *Cf. Broker/Dealer Report, supra,* at xiv (distinguishing brokerage from dealing according to whether transaction is "for the account of the customer" or "for his [the dealer's] own account").

[9] Since well before the present controversy, in interpretations that remain unchanged, federal banking regulators have recognized that bank brokerage "customers" need not have any other relationship with the bank. The Office of the Comptroller of the Currency promulgated regulations in 1979 "applicable to recordkeeping and confirmation requirements for [securities] transactions" effected by national banks that define "customer" as:

> "any person or account . . . for which a national bank effects or participates in effecting the purchase or sale of securities, but . . . [not] a broker, dealer, dealer bank or issuer of the securities which are subject to the transactions."

12 C.F.R. § 12.2(b) (1983). *See* 12 C.F.R. § 208.8(k)(1)(i) (1983) (same definition of "customer" promulgated in 1979 by Federal Reserve Board in relation to securities transactions effected by state member banks); 12 C.F.R. § 344.2(b) (1983) (same definition of "customer" promulgated in 1979 by Federal Deposit Insurance Corporation in relation to securities transactions effected by state nonmember banks); *see also* 44 Fed. Reg. 43,254-63 (1979).

"customers" to encompass only a limited class of persons having specific prior dealings with the bank. Presumably, if Congress had intended such a limitation, it would have specified the nature, duration and extent of the prior relationship required for an investor to be considered a bank "customer". Section 16 does not even suggest how these difficult definitional problems might be resolved, much less give any specific limitations. Absent some such indication of legislative intent to limit the scope of the term,[10] a bank "customer" for purposes of § 16 is simply an investor who comes to the bank for brokerage services.

This Court's decision in *Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* upholding a Board regulation that permitted bank holding companies and their nonbank subsidiaries to act as investment advisers to closed-end investment companies, further suggests that any user of bank brokerage services is a "customer" within the meaning of § 16. In ruling that the advisory relationship at issue in that case was permissible under § 16, the Court noted that "[w]hen an [investment] adviser makes a change in the securities portfolio of a closed-end company, the adviser is acting for the

[10] The legislative history sheds little additional light on this issue. The Glass-Steagall Senate Report merely notes that under § 16 "banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore, but . . . for their own account only under such limitations and restriction as the Comptroller of the Currency may require." S. Rep. No. 77, 73d Cong., lst Sess. 16 (1933). *See also* H.R. Rep. No. 150, 73d Cong., lst Sess. 3 (1933). The legislative history of the Banking Act of 1935, which effected certain technical amendments to the Glass-Steagall Act, *see* n. 11 *infra,* noted only that its amendment of § 16 "ma[d]e it clear that . . . banks may purchase and sell stocks for the account of their customers but not for their own accounts". H.R. Rep. No. 742, 74th Cong., lst Sess. 18 (1935). In each case, the emphasis is on distinguishing permissible agency transactions from impermissible transactions undertaken by a bank as principal, and in neither case is there the slightest evidence of any congressional attempt to limit the number of persons served (as opposed to the type of service provided), of any rationale for such a limitation, or of any guidelines for applying such a limitation.

account of its customer—not for its own account". *Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 66 n.37. Thus, this Court apparently viewed a closed-end company as a "customer" simply on the basis of its receipt of investment advice, without regard to whether other specific banking services were provided. The Court therefore seems to have recognized that the term "customer" as employed in § 16 does not require the extensive preexisting relationship that SIA espouses.

B. The Legislative History Shows that Congress Intended To Permit Banks To Provide Brokerage Services.

The legislative history of the Glass-Steagall Act expressly states that under § 16 "[n]ational banks are to be permitted to purchase and sell investment securities for their customers to the same extent as heretofore . . .". S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933).[11] The intent of Congress, it would therefore appear, was to permit banks to continue their prior practices in the brokerage field.

Prior to the passage of the Glass-Steagall Act, the scope and nature of securities-related activities varied considerably among banks. *See, e.g.,* W. Peach, *The Security Affiliates of National Banks* 70-82 (1941). For that reason alone, it is difficult to suppose that Congress intended to limit banks' brokerage activities to any particular format, much less to the

[11] As initially enacted, §16 of the Glass-Steagall Act referred to "the business of dealing in investment securities" and had permitted national banks to purchase and sell "such securities" for customers' accounts. Banking Act of 1933, Pub. L. No. 66, §16, 48 Stat. 162, 184. The term "investment securities", however, was defined elsewhere in the provision to include only debt securities. *Id.* Thus, the Glass-Steagall Act as initially enacted did not explicitly state that banks were authorized to purchase stocks—equity securities—for customers' accounts. The Banking Act of 1935 amended § 16 to make it clear that national banks could "deal in" "securities *and stock*" for customers' accounts, although not for their own accounts. *See* Banking Act of 1935, Pub. L. No. 305, § 308(a), (b), 49 Stat. 684, 709 (1935). As discussed above, *see* n. 10 *supra,* the legislative history of the 1935 statute sheds little additional light on the permissible extent of bank brokerage activities.

exceedingly narrow bounds petitioner espouses. So far as appears, banks generally did not require any particular form of prior banking relationship as a prerequisite for providing brokerage services, *see id.* at 28-31, 70-82, and in fact some banks offered such services to the general public. For example, one banking industry commentator writing in 1929 stated that banks "will, upon request, though some banks solicit this business, buy and sell securities for [their] customers *and the public in general.*" Smith, *Stock Market Service Comes High,* 21 Am. Bankers A. J. 965 (1929) (emphasis added); *see* W. Peach, *supra,* at 28-31, 70-82. Accordingly, in endorsing prior industry practice, the Glass-Steagall Congress contemplated that commercial banks would continue to provide brokerage services according to their own policies and without particular statutory limitation.

C. Permitting Banks To Provide Brokerage Services Is Consistent with the Purposes of the Glass-Steagall Act.

As noted above, the overriding objective of the Glass-Steagall Act was to limit banks' authority to underwrite certain types of securities, *see* 12 U.S.C. §§ 24 (Seventh), 378 (1982), and to invest in certain securities for their own account, *see id.* § 24 (Seventh) (1982). The purpose of these restrictions was twofold. First, they had the fundamental economic objective of diminishing the commitment of commercial bank assets to long-term securities. Congress believed that the propensity to have bank assets "tied up" in such securities rendered banks illiquid and subjected them unduly to the risks inherent in such investments. *See, e.g.,* S. Rep. No. 77, 73d Cong., lst Sess. 6-7, 8-10 (1933); 76 Cong. Rec. 1405 (1933) (remarks of Sen. Glass). *See also Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 61-62. In addition, the Act has been interpreted as intended to protect commercial bank depositors from abuses possibly associated with the promotional role played by firms engaged in underwriting. In particular, it was the view of some that a commercial bank also acting as an investment banker might imprudently recommend the purchase of securities held or underwritten by it, or might make imprudent loans either to depositors for purposes of purchasing such securities or to the

issuers of the securities. *See generally Investment Company Institute v. Camp,* 401 U.S. 617, 630-34 (1971); U.S. Department of the Treasury, *Public Policy Aspects of Bank Securities Activities,* app. 18-21 (1975).

Brokerage activities do not involve these risks. First, because a commercial bank acting as a broker acts only as an agent for investors, its brokerage activities do not "tie up" bank capital or expose bank assets to the risks of the securities markets. Second, the promotional pressures which were thought to affect the judgment of a bank acting as an underwriter simply do not exist in the case of a bank acting as a broker. Such a bank does not take positions in particular securities for resale to investors, and all it has to promote is the price and quality of its brokerage service. It is fanciful to suggest that banks would give imprudent advice, make imprudent loans or engage in improper self-dealing for the sake of obtaining a slight marginal increase in brokerage commission income. *See New York Stock Exchange, Inc. v. Smith, supra,* 404 F. Supp. at 1099-1100 (banks purchasing and selling securities for the account of customers "do not have a salesman's interest in the securities' performances" and "are in competition with investment brokers only in terms of convenience, cost, and dependability"); *cf. Investment Company Institute v. Camp, supra,* 401 U.S. at 638 (promotional risks addressed by Act not present when bank purchases securities for customers' accounts). *See also* 12 U.S.C. § 1972(1) (1982) (prohibiting certain forms of tying and reciprocity in the furnishing of bank services).

II

THE GLASS-STEAGALL ACT DOES NOT FORBID COMMERCIAL BANK AFFILIATES TO CONDUCT A BROKERAGE BUSINESS.

Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377 (1982), the only provision of the Act that bears directly on bank affiliates such as nonbank subsidiaries of a bank holding

company, *see Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 58 n.24, limits the power of banks to affiliate with firms principally engaged in certain securities-related activities. Section 20 provides in pertinent part:

> "[N]o member bank shall be affiliated . . . with any corporation . . . engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities." 12 U.S.C. § 377 (1982).

SIA contends that brokerage activities constitute the "public sale" of securities within the meaning of § 20, so that a bank affiliate cannot lawfully offer such services. SIA Br. at 34-42. This contention is groundless.

First, it defies logic to argue that § 20 should forbid a bank affiliate to conduct a brokerage business when § 16 of the Act explicitly authorizes banks themselves to do so. SIA's contention that §§ 16 and 20 of the Act are part of a "comprehensive structure governing banks' direct and indirect participation in the prohibited activities" (SIA Br. at 35) completely misses the point. As § 16 demonstrates, the Act was *not* aimed at brokerage activities, but at other activities, especially underwriting. The limitations imposed on bank affiliates by § 20 cannot logically be more restrictive than those imposed on banks by § 16. Indeed, § 20 is intended to be more liberal in that it permits a bank affiliate to engage in activities forbidden to banks under § 16 unless the affiliate is "engaged principally" in such activities. *See Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 64.

Second, it is clear from the statutory context that the phrase "public sale" refers only to the sale of securities as part of an underwriting and has nothing to do with brokerage "sales" occurring in the secondary markets. SIA does not dispute that the other activities referred to in § 20—"the issue, flotation, underwriting . . . [and] distribution" of secu-

rities—characterize the procedures involved in a public offering, the means by which large blocks of securities are transferred to the public through the underwriting process. Given this statutory context, the term "public sale" therefore naturally refers to a similar means of distributing securities to the public. *Cf. Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) (statutory term "gathers meaning from the words around it").

Third, the term "public sale" cannot readily be understood to refer to the brokerage business. Brokers *sell* as agents for their customers, not for their own accounts, and they *buy* as well as sell on their customers' behalf. The term "public sale" is therefore remarkably inapt as a description of the brokerage business. Particularly because § 20 refers to "*public* sale", the statute is obviously aimed at the widespread public selling efforts which characterize an underwriting, not at the sort of transactions which individual buyers and sellers accomplish through their brokers. *See* Note, *A Banker's Adventures in Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services*, 81 Mich. L. Rev. 1498, 1498 n.2 & 1499 n.6 (1983). Congress knew perfectly well how to describe the brokerage business when it wished to do so, and it employed language well suited for that purpose in § 16, 12 U.S.C. § 24 (Seventh) (1982).

Finally, and by no means least important, the Board has long interpreted the term "public sale", as employed in a parallel provision of the Glass-Steagall Act, to exclude brokerage activities. Section 32 of the Act prohibits certain managerial interlocks between commercial banks and firms "primarily engaged in the *issue, flotation, underwriting, public sale, or distribution*" of securities. 12 U.S.C. § 78 (1982) (emphasis added). The Board's Regulation R, which implements this provision, expressly provides that "[a] broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32". 12 C.F.R. § 218.1 n.1 (1983). This regulation, which SIA has failed to address, was

promulgated in 1936 and codifies a Board ruling, 20 Fed. Res. Bull. 393 (1934), made not long after the Act was passed. Regulation R and the ruling it codifies compellingly demonstrate that the term "public sale" does not encompass brokerage activities. *See Board of Governors of the Federal Reserve System v. Agnew*, 329 U.S. 441, 445 & n. 3 (1947).

III

THE BANK HOLDING COMPANY ACT PERMITS A BANK HOLDING COMPANY TO ACQUIRE A BROKERAGE FIRM.

Under § 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982), the provisions of that Act which restrict the power of bank holding companies to acquire shares of nonbanking corporations do not apply to:

> "shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. . . . In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." 12 U.S.C. § 1843(c)(8)(1982).

This provision is generally interpreted as requiring the Board to determine that (1) the activities of the acquired corporation are "closely related" to banking, and (2) the anticipated public benefits of the acquisition outweigh possible adverse effects.

E.g., National Courier Association v. Board of Governors of the Federal Reserve System, 516 F.2d 1229, 1232-33 (D.C. Cir. 1975).

SIA contends that the Court below erred in upholding the order of the Board approving BAC's application to acquire Schwab primarily because Schwab's brokerage activities are merely "similar" to banking activities and are not "closely related" thereto. SIA Br. at 12-19. Specifically, SIA contends that the Bank Holding Company Act permits bank affiliates only "to provide certain bank support activities". *Id.* at 13. In addition, it contends that in enacting certain amendments to the Act in 1970, Congress "refused" to adopt a "functionally related" test for determining which activities are permissible for bank affiliates. *Id.* at 14. As we show below, SIA's contentions misapprehend the pertinent statutory standards. Because banks are expressly authorized to engage in brokerage activities, such activities may lawfully be performed by bank affiliates as well.[12]

A. Bank Affiliate Activities Are Not Limited to Support Services.

The Bank Holding Company Act does not limit bank

[12] SIA no longer presses its argument, made before the Court of Appeals, that the Board applied an incorrect legal standard in evaluating the public benefits of the acquisition. As noted above, § 4(c)(8) of the Bank Holding Company Act requires the Board to consider whether performance of particular activities by a bank holding company subsidiary "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects . . ." and permits the Board to differentiate between "activities commenced de novo and activities commenced by the acquisition . . . of a going concern". The Board found, and the Court of Appeals agreed, that BAC's acquisition of Schwab will create public benefits by increasing competition, convenience and efficiency. *BankAmerica Corp. (Schwab)*, 69 Fed. Res. Bull. 105, 109-10 (1983).

affiliates to providing certain support services for banking operations. Were bank affiliate activities so limited, then they could not provide the wide array of services—including credit card operations, factoring, leasing, and real estate appraisal—which they are now authorized to perform. *See* 12 C.F.R. § 225.4 (1983), *to be recodified at* 12 C.F.R. § 225.25, *see* 49 Fed. Reg. 794 & 818 (1984). Congress' intent in restricting the activities that may be conducted by bank affiliates was not to confine bank affiliates to the same activities as banks, but "to divorce the bank holding companies from their *industrial empires*", 102 Cong. Rec. 6755 (1956) (emphasis added), and to prevent bank holding companies from acquiring "centralized control [of] an *unlimited number and variety of businesses*". H.R. Rep. No. 609, 84th Cong., 1st Sess. 4 (1955) (emphasis added).[13] A bank holding company's acquisition of a financial services firm—particularly one performing services lawfully performed by banks—is hardly the sort of conglomeration the Act was designed to prevent.

Moreover, SIA's arguments to the contrary notwithstanding, the intent of Congress in amending § 4(c)(8) of the Act in 1970 is, as this Court has observed, "difficult to discern". *Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 73. Certainly SIA errs in asserting that Congress "refused" to adopt a "functionally related" standard (SIA Br. at 14, 16), when Senator Sparkman, a member of the Conference Committee responsible for the language of the amendment, commented that the wording ultimately adopted "differs only slightly in language and *none in substance*" from the "functionally related" language originally proposed by the Board. 116 Cong. Rec. 42,432 (1970)

[13] The kind of bank holding company diversification to be prevented by the Act was exemplified by one bank holding company that either owned or controlled not only several banks, but also industrial firms engaged in:

> "oil and gas, fish canning and processing, frozen foods, castings, forge equipment, kitchen tools, and agricultural equipment." H.R. Rep. No. 609, 84th Cong., 1st Sess. 4 (1955).

(emphasis added).[14] Courts have in fact consistently held that bank holding company subsidiaries may perform services that are "operationally or functionally similar" to banking services. *See National Courier Association v. Board of Governors of the Federal Reserve System, supra,* 516 F.2d at 1237; *Alabama Association of Insurance Agents v. Board of Governors of the Federal Reserve System,* 533 F.2d 224, 241 (5th Cir. 1976), *vacated in part,* 558 F.2d 729 (5th Cir. 1977), *cert. denied,* 435 U.S. 904 (1978); *Association of Bank Travel Bureaus, Inc. v. Board of Governors of the Federal Reserve System,* 568 F.2d 549, 551 (7th Cir. 1978); *NCNB Corp. v. Board of Governors of the Federal Reserve System,* 599 F.2d 609, 613 (4th Cir. 1979).

In any event, as we show below, the provision of discount brokerage service is "closely related" to banking within the meaning of the statute as it has been consistently interpreted by Federal banking regulators and by the lower Federal courts.

B. Brokerage Activities Are "Closely Related" to Banking.

As discussed above, Section 16 of the Glass-Steagall Act expressly authorizes commercial banks to conduct a brokerage business. *See* pp. 3-17, *supra.* Because Congress has included the power to buy and sell securities for the account of customers among the powers of banks, it is indisputable that these brokerage activities are "so closely related to banking . . . as to be a proper incident thereto". 12 U.S.C. § 1843(c)(8)(1982). In this respect, operation of a brokerage business by a bank holding company is similar to the operation of any other

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[14] The legislative history of the 1970 amendment is recapitulated by this Court in *Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 72-78. Originally, the Board had urged adoption of a "functionally related" test to determine the propriety of bank affiliates' activities. Language incorporating this test was passed by both Houses of Congress, but was dropped by the Conference Committee in the final version of the bill. The Conference Committee Report, which was signed by only four of seven House conference managers, indicated that Congress had not adopted the more liberal standard. The Report was later criticized as "an inaccurate indication of the conference's intent". *See id.,* 450 U.S. at 73-75 & n.54.

business that has been found, by statute or regulation, to be "incidental . . . [to] the business of banking", 12 U.S.C. § 24 (Seventh) (1983), or "closely related to banking", 12 C.F.R. § 225.4, *supra.*[15] We submit that the explicit statutory authority is conclusive on the "closely related" issue.

Even if this authority were not conclusive, however, SIA's contentions would not justify overturning the Board's determination under the "closely related" standard. In *National Courier Association v. Board of Governors of the Federal Reserve System, supra,* a leading decision in which the District of Columbia Circuit construed the "closely related" standard of § 4(c)(8), the Court that:

> "at least the following seem to us within the statutory intent:
>
> > "1. Banks generally have in fact provided the proposed services.
> >
> > "2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
> >
> > "3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form." 516 F.2d at 1237.

Of these three criteria, which are posed in the alternative and are not exhaustive, *see id.,* both the first and the second undoubtedly apply to the brokerage activities at issue here. As shown above, banks have long performed all the functions of a securities broker, including direct execution of securities transactions. *See* pp. 3-8, *supra.* Moreover, as the Board determined as a result of its exhaustive inquiry on the present application, many banks routinely offer various securities ser-

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[15] Such activities include, but are not limited to, credit card and factoring operations, loan servicing, investment and financial advising, leasing of personal property, financial, banking or economic data processing, financial courier services, financial management consulting, and real estate appraisal. *See* 12 C.F.R. § 225.4, *supra.*

vices, particularly in connection with their management of trust and custodial accounts, which closely parallel those of an ordinary brokerage business. *BankAmerica Corp. (Schwab), supra,* 69 Fed. Res. Bull. at 107-08. In short, SIA's contentions cannot obscure the fact that the buying and selling of securities on an agency basis has been a common banking practice throughout this century, *see Board of Governors of the Federal Reserve System v. Investment Company Institute, supra,* 450 U.S. at 55; *see also* pp. 3-8, *supra,* and is therefore "so closely related to banking . . . as to be a proper incident thereto" within the meaning of § 4(c)(8).

CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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Of Counsel.

April 5, 1984

NO. 83-614

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

V.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ET AL.,
Respondents.

On Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF AMICUS CURIAE, THE LEGAL FOUNDATION OF AMERICA, SUPPORTING AFFIRMANCE

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MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

The Legal Foundation of America respectfully requests leave to file the attached brief of amicus curiae and would show the Court as follows:

1. *Identity of Amicus Curiae:* The Legal Foundation of America ("LFA") is a nonprofit corporation supporting the operations of a public interest law firm as that term is defined in IRS regulations. It is located on the campus of the South Texas College of Law in Houston and shares certain activities and personnel with the law school. LFA has expertise in matters of economics and public policy. All litigation undertaken by LFA is approved by its Board of Trustees, which consists of attorneys, academics and businesspeople.

2. *Interest of Amicus Curiae:* Among LFA's principal aims are the improvement of the use of the market system of resource allocation and removal of unreasonable regulation. LFA has participated as amicus curiae in this honorable Supreme Court, in the federal courts of appeals, in federal district courts, and in the courts of the several states, in pursuit of these goals. It has supported reliance on the market or has attempted to enhance the

efficiency of regulation in such diverse industries as broadcasting, health care, natural gas production, mining, insurance, and commercial lending.

3. *Desirability of an Amicus Curiae Brief:* The decision under review offers the potential of procompetitive benefits in one of the most fundamental markets in our economy, the capital market. The legitimacy of that decision depends in turn upon the interpretation of statutes and, hence, the discerning of legislative intent, as well as upon a review of the decision in its economic context. LFA's activities in regulatory cases have frequently required it to consider interpretation of statutes. LFA is in a position to do so from a perspective different from that of the parties, i.e., a perspective of public policy. Furthermore, LFA's expertise in the application of law to economic matters makes it likely that LFA can assist the Court in fully developing the issues in this regard. Although the parties are clearly represented by capable and diligent counsel, their perspectives on the case make it unlikely that all such issues will be developed in the absence of amicus curiae briefing.

4. *Necessity of Motion; Refusal of Consent by Petitioner Securities Industry Association:* Movant timely requested consent of the parties. This motion is necessary because of the refusal of consent by one party, Petitioner SIA.

FOR THESE REASONS, the Legal Foundation of America moves for leave to file the attached brief of amicus curiae.

Respectfully submitted,

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BRIEF OF AMICUS CURIAE,
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INTEREST OF AMICUS CURIAE

Paragraphs 1 and 2 of the Motion for Leave preceding this Brief are adopted at this point as showing the interest of amicus curiae.

SUMMARY OF ARGUMENT

This amicus curiae brief deals primarily with Glass-Steagall Act issues. Although some of the statutory construction arguments herein are also applicable to the Bank Holding Company Act, the latter is not our primary focus. Amicus has attempted to avoid unnecessary duplication of Respondents' arguments, though we agree with those arguments and wish to express support for them.

I.

Petitioner SIA uses statutory construction principles erroneously in this case. For example, it begins its brief by citing

remarks made in one committee of Congress nearly 50 years after passage of the Glass-Steagall Act. The use of isolated remarks to construe legislation is not appropriate. Neither is the use of statements in one legislature to construe another Congress' intent. What Petitioner SIA really seeks by this argument is to create a kind of "legislative veto" based on isolated remarks from one committee of the Congress.

II.

There are several traditional techniques for determining legislative intent. When the traditional approaches are applied in this case, the conclusion is overwhelming that the Board's action should be affirmed. The opinion of the Court of Appeals correctly applies these traditional criteria.

III.

The Board's actions here do not offend any of the purposes of the legislation in question. On the contrary, the Board's action effectuates the repeatedly expressed congressional policy in favor of competition and efficiency.

ARGUMENT AND AUTHORITIES

I. TRADITIONAL PRINCIPLES OF STATUTORY CONSTRUCTION SUPPORT THE BOARD'S DECISION AND CONTRADICT SIA'S ARGUMENTS.

A. *Petitioner SIA's Statutory Construction Arguments are Erroneous.*

1. Petitioner SIA seeks a kind of "legislative veto" based on remarks in one committee of Congress. SIA begins its argument by citing remarks lifted from the report of one committee in the current Congress.[1] It asserts that the committee was opposed to

1 Brief of Petitioner at 6. The committee directed its remarks to the Federal Home Loan Bank Board, which is a separate entity with

the action at issue here (although it in fact addressed a different agency altogether). SIA's argument is ironic, in that this Court has rejected the "one house" legislative veto. *INS v. Chadha*, 103 S. Ct. 2764 (1983). If SIA should succeed in this argument, it would not only thus reinstate the legislative veto, but would extend it to a single committee.

2. *Petitioner SIA's argument that "Congress watched in frustration" is erroneous and misleading, particularly since SIA omits to mention substantial support for the Board's action.* SIA's argument that Congress "watched in frustration" ignores the fact that a majority of Congress need never "watch in frustration" in a case such as this one, because a one-sentence enactment would have cured the frustration if it existed.[2] SIA reaches its odd conclusion by presenting random remarks by a minority of members as though they were the universal conviction of a monolithic Congress.[3] In doing so, SIA omits the views of current members who are undecided, those who are leaning but not

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separate responsibilities from the Federal Reserve Board. In any event, such remarks are not a proper means of construing legislation.

2 "Although a subsequent legislature has power to change an Act to achieve whatever prospective meaning or effect it desires, it has been held that the views of members of subsequent legislatures as to the meaning of Acts passed by previous legislatures are not entitled to much weight." 2A C. SANDS, SUTHERLAND STATUTORY CONSTRUCTION 222 (3d ed. 1973), citing United States v. Philadelphia National Bank, 374 U. S. 321 (1963).

3 Petitioner's approach might be compared with W. STATSKY, HOW TO USE STATUTES AND REGULATIONS 21 (1975):

> What is a legislature? . . . [I]t is an organization of hundreds of individuals within two units (e.g., House and Senate) . . . . [I]t can safely be said that not every individual had the same objective, the same intent or intention. Some members of the legislature may have been only vaguely familiar with [the issue].

"Committees rarely speak with a single thought, with a single consistent objective." J. DAVIES, LEGISLATIVE LAW AND PROCESS IN A NUTSHELL 241 (1975). "A legislative act emerges from the hubbub of legislative struggle." Id.

committed, and those in the substantial number who supported the Board's action here.[4]

3. SIA's use of remarks in one Congress, to interpret a statute passed by another Congress nearly fifty years earlier, is inappropriate. Legislation results when a consensus is forged. The fact of consensus, and the process by which it is reached, are important to our system of legislation.[5] Thus *contemporaneous*[6] statements of legislative intent, producing or expressing consensus, are appropriate aids to statutory interpretation. But chance minority remarks by members of another legislature fifty years later, which did not go through the process of reaching consensus, are not useful.[7] This Court has had occasion to explain the danger in interpreting one Congress's legislation by remarks in another Congress,[8] and SIA's efforts to do so here are equally inappropriate.

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4 It is submitted that, in fact, SIA's implication of substantial opposition in the current Congress is not supportable. But amicus curiae does not rely upon either that conclusion or the conclusion that Congress would have favored the Board's action, because use of remarks in the current Congress to interpret legislation by another Congress is inappropriate.

5 See generally INS v. Chadha, supra ("legislative veto" contravenes requirement of passage by both houses, coupled with Presidential signature, contemplated by Constitution). The concurring opinion of Mr. Justice Powell pointed out that such legislative action may also infringe on the judicial power by effecting an adjudication upon a statute, and this analysis, too, is applicable here.

6 See 2A SUTHERLAND, supra note 2, at 233 (emphasizing requirement that interpretation be "contemporaneous" to be relevant); DAVIES, supra note 3, at 262 ("Interpretations of statutes contemporaneous with their passage are relevant guides to later interpretation").

7 See note 2 supra and authorities therein cited.

8 E.g., United States v. Philadelphia National Bank, 374 U. S. 321 (1963); see also 2A SUTHERLAND, supra note 2, at 222.

4. Congress emphatically intended the Federal Reserve Board (which is bipartisan and is composed largely of appointees of prior administrations) to act independently of short-term political remarks in the Congress. If there is anything that is crystal clear about the Federal Reserve Board, it is that it is an *independent* agency.[9] Congress sought to insulate it from short-term politics.[10] SIA's effort to use remarks by a few members of Congress to affect the legality of this independent Board's actions is squarely in violation of this important Congressional policy. Furthermore, SIA's implication that the Board's action is a radical departure neglects the fact that the Board is bipartisan by custom and is now composed almost entirely of members who were initially appointed by previous administrations, as it was at the time of this decision.[11]

B. The Board's Interpretation of the Legislation is Supported by Traditionally Accepted Criteria for Determining Congressional Intent.

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9 Federal Reserve Act, 12 U. S. C. sec. 221 (1976).

10 See, e.g., Cong. Rec. 169-179 (1913).

11 The membership of the Board of Governors, just before this decision, was as follows:

FEDERAL RESERVE SYSTEM GOVERNORS
(Seven members appointed for 14-year terms; no statutory limitation on political party membership.)

	Party:	Term Expires:	Confirmed:
Paul A. Volcker (C)	D	1/31/92	8/2/79
Nancy H. Teeters	D	1/31/84	9/15/78
J. Charles Partee	I	1/31/86	12/19/75
Henry C. Wallich	R	1/31/88	6/12/79
Emmett J. Rice	D	1/31/90	6/12/79
Lyle E. Gramley	D	1/31/94	5/15/80
Preston Martin	R	1/31/96	3/31/82

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Traditional factors for determining legislative intent include:[12] (1) historical events preceding the legislation;[13] (2) ascertainable remedial purposes;[14] (3) contemporaneous expressions of legislative intent by legislators; (4) similar constructions of words in a series (the *ejusdem generis* doctrine);[15] (5) omission from one section of a word used in other section (the *expressio unius, exclusio alterius* principle);[16] (6) deference to the expertise of an administrative agency in construing the statute it

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12 See generally 2A SUTHERLAND, supra note 2, Pt. V (A) ("Statutory Interpretation: Principles and Policies"); STATSKY, supra note 3, Pt. II ("The Techniques of Legislative Analysis"); DAVIES, supra note 3, ch. 13. ("Statutory Interpretation"). While the principles and factors listed here are not exhaustive, they are the approaches that are most clearly applicable.

13 The clear historical event underlying the Glass-Steagall Act, for example, was the instability of the national banking system, which culminated in a banking holiday declared by the President in the year of passage of the Act (1933). Since, as the Board and Court of Appeals held, the kind of acquisition in question in this case has none of the potential for instability displayed by the events to which Glass-Steagall was directed, this factor supports the Board's interpretation. Cf. Investment Co. Institute v. Camp, 401 U. S. 617, 629 (1971) ("ICI I").

14 The three purposes identified with Glass-Steagall (maintaining stability, encouraging public confidence, and preserving disinterested investment advice; see note 26 infra and accompanying text) are not affected by the kind of acquisition at issue, as the Board and the Court of Appeals correctly held.

15 Thus the term "public sale" in the list of activities prohibited bank affiliates may be interpreted as ejusdem generis ("of the same species") with the other words in the series "issue, flotation, underwriting, public sale, or distribution . . . ." in the Glass-Steagall Act, section 20.

16 Thus section 20, which applies to bank affiliates, omits to prohibit "the business of dealing in securities and stock," which is prohibited to banks themselves by section 16. Since banks and bank affiliates are differently treated, and since the prohibition omitted from one section is contained in another only four sections removed, the omission is particularly conspicuous.

is charged with administering; [17] (7) common usage of the word in the trade that is regulated; [18] (8) previous constructions of the terms by the courts; and (9) policy (such as the policy favoring competition). [19]

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17 Only a few days before the filing of this Brief, this honorable Supreme Court reaffirmed this principle:

> [O]n an issue that implicates its expertise . . . , a reasonable construction by the Board is entitled to considerable deference . . . . The question for decision today is thus narrowed to whether the Board's application of [the statute at issue] is reasonable.

NLRB v. City Disposal Systems, Inc., ____ U. S. L. W. ____ (U. S. S. Ct., Mar. 21, 1984).

The Federal Reserve Board's determinations are entitled not just to "considerable" deference, but to "the greatest" deference. Board of Governors v. Investment Co. Institute, 450 U. S. 46 (1981) ("ICI II"). The Court has explained this standard as follows:

> Not only because Congress has committed the system's operation to their hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated judgment in all its phases, I think their judgment should be conclusive on any matter which, like this one, is open to reasonable difference of opinion.

Board of Governors v. Agnew, 329 U. S. 441 (1947).

18 "The general rule is that in the absence of a manifested legislative intent to the contrary or other overriding evidence of a different meaning, commercial terms when used in a statute relating to trade or commerce are presumed to have been used in their trade or commercial meaning." 2A SUTHERLAND, supra note 2, at 155. "Public sale" thus means underwritten sale.

19 "[T]he tendency of the courts has always been to favor interpretations which are consistent with public policy." 2A SUTHERLAND, supra note 2, at 401. In fact, most rules of strict or liberal construction "are founded on considerations having to do with policy one way or another." Id. Policy expressed in other statutes is relevant. Id. at 403-04. The policy favoring competition is to be found in many statutes that are appropriately read together with Glass-Steagall. See Part II of this Brief, infra.

The opinion of the Second Circuit considers all of these factors and correctly concludes that they support the Board's interpretation.[20] Petitioner SIA, on the other hand, misapplies these doctrines. It uses non-contemporaneous statements.[21] It divorces contemporaneous legislative statements from their context and from their remedial purpose.[22]

Furthermore, SIA misuses the doctrine of *in pari materia.* This doctrine, which requires that separately enacted legislation be construed so as to produce coherent regulation,[23] is used by SIA in an effort to make bank affiliates (governed by section 20 of Glass-Steagall) be regulated identically to banks (governed by section 16). This approach is erroneous, first, because identical

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20 See notes 12-19 supra and accompanying text.

21 See notes 2, 5-8 supra and accompanying text.

22 For example, Petitioner's Brief at 20-21 relies heavily upon remarks of Representative Koppleman, to the effect that "[t]he unholy alliance between the brokerage office and the banks must be broken." 77 Cong. Rec. 3907 (May 22, 1933). Petitioner fails to point out, however, that at the time, banks were allowed to speculate in securities and underwrite securities. The concern was with these kinds of bank activities, because they threatened stability, lessened public confidence, or interfered with disinterestedness in investment advice by banks, and not with disinterested brokerage.

Thus, Rep. Koppleman juxtaposed the quoted remarks with statements that the Act would prevent "diversion of banking funds into speculative operations;" that it would force bankers to give "impartial" advice; and that it would forbid bankers to "promote" or "underwrite" stocks. Id. Koppleman's remarks closed as follows:

> This provision will drive the speculator from the inner councils of the banks. It will restore the honest banker to the position of dignity and prestige, to which his character and ability entitle him. [Applause].

Id. In context, the remarks of Rep. Koppleman are clearly concerned with unstable investment practices, public confidence, and disinterested advice, and the remarks can only be represented as applying to discount brokerage if the context is ignored.

23 See, e.g., 2A SUTHERLAND, supra note 2, ch. 51.

treatment of banks and bank holding companies is not logically required and indeed is contrary to the thrust both of Glass-Steagall and of the Bank Holding Company Act.[24] Secondly, since the two sections are part of one act, rather than appearing in diverse acts that must be reconciled, the appropriate principle is not the *in pari materia doctrine* but rather the *expressio unius, exclusio alterius* principle. The omission from one section of language that appears in another section a few lines away in the same statute is a strong indication that it was intended to be omitted.[25]

II. THE BOARD'S ACTION FOSTERS COMPETITION AND EFFICIENCY, AND THUS IT CARRIES OUT A FREQUENTLY EXPRESSED CONGRESSIONAL PURPOSE.

The Glass-Steagall Act seeks to preserve the stability of bank assets, protect public confidence in banking, and prevent conflicts of interest in investment advice.[26] None of those purposes would be carried out by reversing the Board here.[27]

Since that is the case, it is relevant to consider that the Congressional policy in favor of fostering competition and efficiency is advanced by the Board's actions. This policy is expressed in

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24 "In both the Glass-Steagall Act itself and in the Bank Holding Company Act, Congress indicated that a bank affiliate may engage in activities that would be impermissible for the bank itself." Board of Governors v. Investment Co. Institute, 450 U. S. 46, 64 (1981) ("ICI II").

25 See note 16 supra and accompanying text.

26 See Clark, Judicial Interpretation of Glass-Steagall: The Need for Legislative Action, 92 BANKING L. J. 721, 725 (1980).

27 The simplest way to state the reason is that Schwab's brokerage is brokerage only, with no equity interest in the sales and no investment advice.

such general enactments as the antitrust laws, and it is also expressed in such banking industry enactments as the Bank Holding Company Act.[28]

SIA is engaged in a comprehensive effort to exclude competition and protect inefficient operations from it. The historical monopolization of odd-lot trading,[29] "bundling" by full-line brokers,[30] internal and external exchange regulation, and resistance to discount brokerage[31] are a part of this effort, as are litigation initiatives such as the present one.

The Board's action will make discount brokerage more readily available. This conclusion is overwhelmingly supported by the evidence. By reducing the cost of brokerage, the Board's action will reduce a major impediment preventing equity funds from shifting, when necessary, seek out the best investments. The Board's action will thus make capital markets function more efficiently, allocate resources better, and reduce transaction costs, in accordance with the congressional policy of competition.

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28 As to the antitrust laws, see, e.g., 1 E. KITNER, THE ANTITRUST LAWS 1-6 (1980); as to the Bank Holding Company Act, see 28 U. S. C. sec. 1843 (c) (8) (1976) (explicitly requiring assessment of "competition" and "efficiency" in the present case).

29 Cf. Eisen v. Carlisle & Jacquelin, 417 U. S. 156 (1974) (reporting district court finding of monopolization preliminary to class certification, rev'd on other grounds).

30 Until the advent of discount brokerage, it was not possible to obtain brokerage unassociated with other services for which the customer would have to pay whether he wanted them or not, because they were sold as a "bundle." One of the procompetitive effects found by the Board here is that it may promote efficient "unbundling" by full-line brokers.

31 Discount brokerage is a surprisingly recent development, having been initiated in the mid-1970's.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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No. 83-614-CFX
Status: GRANTED

Title: Securities Industry Association, Petitioner
v.
Board of Governors of the Federal Reserve System, et al.

Docketed:
October 13, 1983

Court: United States Court of Appeals for the Second Circuit

Counsel for petitioner: Weidner, James B.

Counsel for respondent: Solicitor General, Lerman, Arnold M.

Entry	Date	Note	Proceedings and Orders
1	Oct 13 1983	G	Petition for writ of certiorari filed.
2	Oct 13 1983		Appendix of petitioner Securities Industry Assn. filed.
4	Nov 11 1983		Order extending time to file response to petition until December 16, 1983.
5	Nov 11 1983		NOTE: The above extension is for ALL RESPONDENTS.
6	Dec 16 1983		Brief of respondent Bankamerica Corp. in opposition filed.
7	Dec 19 1983		Order further extending time to file response to petition until December 23, 1983.
8	Dec 22 1983		Brief of respondent Bd. of Gov. of Fed. Reserve in opposition filed.
9	Jan 4 1984		DISTRIBUTED. January 20, 1984
10	Jan 12 1984	X	Reply brief of petitioner Securities Industry Assn. filed.
11	Jan 23 1984		Petition GRANTED.
			**
12	Mar 2 1984		Joint appendix filed.
13	Mar 6 1984		Brief of petitioner Securities Industry Assn. filed.
14	Mar 15 1984		Record filed.
15	Mar 15 1984		Certified original record & C.A. proceedings received.
16	Mar 20 1984		SET FOR ARGUMENT. Tuesday, April 24, 1984. (3rd case)
17	Apr 5 1984		Brief of respondent Bankamerica Corp. filed.
18	Apr 5 1988		CIRCULATED.
19	Apr 5 1984		Brief amicus curiae of American Bankers Association, et al. filed.
20	Apr 5 1984	G	Motion of Legal Foundation of America for leave to file a brief as amicus curiae filed.
21	Apr 6 1984	X	Brief of respondents Bd. of Gov. of Fed. Reserve, et al. filed.
22	Apr 16 1984		Motion of Legal Foundation of America for leave to file a brief as amicus curiae GRANTED.
23	Apr 17 1984	X	Reply brief of petitioner Securities Industry Assn. filed.
24	Apr 24 1984		ARGUED.